Supreme Court, U.S.
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No. _____

In The

Supreme Court of the United States

SURETY INVESTMENT RECOVERY SERVICES, INC.,

Petitioner,

v.

AMERICAN INSURANCE COMPANY, SEABURY & SMITH, INC., AND NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PA,

Respondents.

On Petition For Writ Of Certiorari To The Supreme Court Of Washington

APPENDICES TO PETITION FOR WRIT OF CERTIORARI

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APPENDIX A

THE SUPREME COURT OF WASHINGTON

[SURETY INVESTMENT RECOVERY SERVICES, INC., Petitioner,] v. SEABURY & SMITH, INC., a Delaware corporation; and NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PA, a Pennsylvania corporation, Defendants, AMERICAN INSURANCE COMPANY, a Nebraska corporation, Respondent.	NO. 69652-7 **ORDER** C/A NO. 22670-7-II (Filed Sept. 5, 2000)

Department I of the Court considered this matter at its September 5, 2000, Motion Calendar, and unanimously agreed that the following order be entered.

IT IS ORDERED:

That the Petition for Review is denied. DATED at Olympia, Washington this 5th day of September, 2000.

/s/ Richard P. Guy
CHIEF JUSTICE

THE SUPREME COURT
STATE OF WASHINGTON
[SEAL]

C.J. MERRITT
SUPREME COURT CLERK
RONALD R. CARPENTER
DEPUTY CLERK/
CHIEF STAFF ATTORNEY

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July 7, 2000

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Re: Supreme Court No. 69652-7 – Kochcapital, Inc., et al. v. Seabury & Smith, Inc., et al.
Court of Appeals No. 22670-7-II

Counsel:

The following notation order was entered on July 7, 2000, by the Supreme Court Commissioner in the above entitled cause:

MOTION FOR SUBSTITUTION OF PARTIES:

"No other party having objected, that substitution appearing to be proper under RAP 3.2(a), the motion is granted."

/s/ Geoffrey Crooks,
Commissioner.

Sincerely,
Ronald R. Carpenter
RONALD R. CARPENTER
Supreme Court Deputy Clerk

GC:crf

NO. 22670-7-II

SUPREME COURT OF THE STATE OF WASHINGTON

SURETY INVESTMENT RECOVERY SERVICES, INC.,

Petitioner,

v.

SEABURY & SMITH, INC., NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PA, and AMERICAN INSURANCE COMPANY,

Respondents.

APPEAL FROM THE COURT OF APPEALS
OF THE STATE OF WASHINGTON, DIVISION II

MOTION FOR SUBSTITUTION OF PARTIES

John M. Keefe, WSBA 18371
Attorney for Petitioner

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1120 Fremont Avenue
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I. IDENTITY OF MOVING PARTY

Petitioner Surety Investment Recovery Services, Inc., assignee of the appellants' interest in the rulings being reviewed, asks for the relief in Part II below.

II. STATEMENT OF RELIEF SOUGHT

Substitution of Surety Investment Recovery Services, Inc., in place of the appellants Thomas Cacciola, Marlene Cacciola, Peter Vetrano, Lena Vetrano, and Wallace Rudolph and Janet Rudolph.

III. FACTS RELEVANT TO MOTION

The appeal was timely filed by the appellants on January 5, 1998. (CP 1902-16). The appeal addresses orders in favor of the American Insurance Company ("American") granting its motion for summary judgment (CP 776-77), denying a motion by the plaintiffs to amend the second amended complaint (CP 774-75), and denying plaintiffs' motion for reconsideration. (CP 802-03). These orders were entered on January 31, 1997, and March 7, 1997.

The appeal also addresses discovery and summary judgment orders that were entered in favor of Seabury & Smith, Inc. ("Seabury & Smith"), and the National Union Fire Insurance Company of Pittsburgh, PA ("National Union") on December 5, 1997, (CP 1831; CP 1827), and the denial of a motion for reconsideration filed by plaintiffs of the denial of motions to compel on January 16, 1998. (CP 1942). On August 24 and November 5, 1998, stipulated motions to dismiss on the fidelity bond claims were filed with the Court of Appeals. On August 31 and December 11, 1998, orders of dismissal were entered by the Court. The appeal of issues that concern Seabury & Smith and National Union is based on public interest guidelines and summary judgment standards expressed by the Supreme Court in its cases. *Purchase v. Meyer*, 108

Wn.2d 220, 229-30, 737 P.2d 1005 (1987); *Graves v. P.I. Taggares Co.*, 94 Wn.2d 298, 300-03, 616 P.2d 1223 (1980).

On February 25, 2000, the Court of Appeals, Div. II, filed its opinion affirming the grant of summary judgment in favor of American, Seabury & Smith and National Union.

On March 15, 2000, appellants filed a motion for reconsideration requesting that the Court reverse or modify its opinion with evidence in the appendix of the formation of Surety Investment Recovery Services, Inc., a Delaware corporation, formed to recover and distribute surety bond proceeds on the rescission orders in SEA-535, and to public customers on accounts maintained by Kochcapital, Inc. ("KI"), between 1988 and 1991 in states where surety bonds were in place (Alaska, Arizona, Hawaii, Idaho, Iowa, North Dakota, Oregon, and South Carolina) before its cessation of business in 1991.

In December 1999, appellants assigned and transferred all title, rights and interests held by them in the surety bonds previously acquired from KI to Surety Investment Recovery Services, Inc. In April 2000, appellants assigned and transferred all title, rights and interests held by them in the fidelity bonds acquired from KI, and all causes of action and all claims which appellants have against Seabury & Smith and National Union, to Surety Investment Recovery Services, Inc. (see accompanying declaration).

IV. GROUNDS FOR RELIEF & ARGUMENT

Rule of Appellate Procedure 3.2(a) provides that, "[T]he appellate court will substitute parties to a review when it appears that a party is deceased or legally incompetent or that the interest of a party in the subject matter of the review has been transferred." RAP 3.2(a) thus authorizes substitution of parties when the interest of a party in the subject matter of the review has been transferred. There is no question that the appellants have transferred all title and interests held by them in the surety and fidelity bonds acquired from KI to Surety Investment Recovery Services, Inc. The substitution is clearly appropriate because the respondents have no claims against the appellants, and the appellants no longer have any interest in the rulings which are the subject matter of this appeal.

DATED: May 12, 2000

Respectfully submitted,

/s/ John M. Keefe
John M. Keefe
Attorney for Petitioner,
WSBA # 18371

DECLARATION

I am the attorney of record for the petitioner. All statements made herein are based upon my personal knowledge.

1) On December 28, 1999, I formed Surety Investment Recovery Services, Inc., a close corporation organized under the laws of the state of Delaware. The

corporation is authorized to issue 1,000 shares of no par value stock. I am currently the interim manager and attorney for the corporation, however, I own and hold no stock in the company. I have been and am currently searching for a competent and neautral party to administer the affairs of the corporation.

2) Concurrent with the formation of Surety Investment Recovery Services, Inc., the appellants Thomas Cacciola, Marlene Cacciola, and Peter Vetrano and Lena Vetrano in *Thomas Cacciola et al. v. American Insurance Company, et al.* (COA # 22670-7-II) assigned and transferred all rights, title and interests held by them in the surety bonds they acquired from Kochcapital, Inc., to Surety Investment Recovery Services, Inc. Appellants Wallace Rudolph and Janet Rudolph were not signatories to, and were not a part of, the assignment of surety bonds from Kochcapital to Thomas Cacciola, Marlene Cacciola, and Peter Vetrano and Lena Vetrano.

3) In April 2000, appellants Thomas Cacciola, Marlene Cacciola, Peter Vetrano, Lena Vetrano, and Wallace Rudolph and Janet Rudolph in *Thomas Cacciola et al. v. American Insurance Company, et al.* (COA # 22670-7-II) assigned and transferred all rights, title and interests held by them in the fidelity bonds acquired from Kochcapital, and all causes of action and all claims which appellants have against Seabury & Smith and National Union, to Surety Investment Recovery Services, Inc.

I declare under penalty of perjury under the laws of the state of Washington that the foregoing is true and correct.

DATED: May 12, 2000, at Pasadena, CA.

/s/ John M. Keefe
John M. Keefe

NO. 22670-7-II

SUPREME COURT OF THE STATE OF WASHINGTON

SURETY INVESTMENT RECOVERY SERVICES, INC.,

Petitioner,

v.

SEABURY & SMITH, INC., NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PA, and AMERICAN INSURANCE COMPANY,

Respondents.

APPEAL FROM THE COURT OF APPEALS
OF THE STATE OF WASHINGTON, DIVISION II

NOTICE OF MOTION

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TO: Clerk of Court, Supreme Court of the State of Washington

AND TO: Richard L. Lambe, Esq., Ulin & Lambe, P.S., Attorneys for American Insurance Company;

Phillip H. Ginsberg, Esq., Stokes Lawrence, P.S., Attorneys for Seabury & Smith, Inc.;

Thomas D. Adams, Esq., Bullivant, Houser, Bailey, Pendergrass & Hoffman, Attorneys for National Union Fire Insurance Company.

PLEASE TAKE NOTICE that the petitioner, Surety Investment Recovery Services, Inc., has filed a Motion for Substitution of Parties in this action, and that the motion will be heard by the Supreme Court concurrently with the Petition for Review, or at such time and place to be designated by the Court.

Dated: May 12, 2000.

Respectfully submitted,

/s/ John M. Keefe
John M. Keefe, WSBA 18371
Attorney for Petitioner

NO. 226 70-7-II

SUPREME COURT OF THE STATE OF WASHINGTON

SURETY INVESTMENT RECOVERY SERVICES, INC.,

Petitioner,

v.

SEABURY & SMITH, INC., NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PA, and AMERICAN INSURANCE COMPANY,

Respondents.

APPEAL FROM THE COURT OF APPEALS
OF THE STATE OF WASHINGTON, DIVISION II

PETITION FOR REVIEW

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I. IDENTITY OF PETITIONER

The petitioner, Surety Investment Recovery Services, Inc., a Delaware corporation, respectfully asks this Court to accept review of its causes of action against Seabury & Smith, Inc., a Delaware corporation, National Union Fire Insurance Company, a Pennsylvania corporation, and American Insurance Company, a Nebraska corporation.

II. COURT OF APPEALS DECISION

Petitioner seeks review by the Supreme Court of Washington of the decision of Division II of the Court of

Appeals terminating review of this case. The decision was filed on February 25, 2000. A timely motion for reconsideration and a motion to supplement the record were filed on March 15, 2000, and March 24, 2000. These motions were denied on March 31, 2000. Copies of the February 25 and March 31 decisions are in Appendix A at pgs. 1-9 & 10.

III. ISSUES PRESENTED FOR REVIEW

- Can the American Insurance Company, as a surety, be sued by an insured principal on surety bonds it issued for the principal, where the bonds are for the benefit of any person having a cause of action under the provisions of the surety bonds?
- May summary judgment and discovery issues relating to Seabury & Smith, Inc., and the National Union Fire Insurance Co., be reviewed by this Court on the grounds that the issues are of continuing and substantial public interest in Washington and across the country where these issues arise?

IV. STATEMENT OF THE CASE

Introduction. This is an action for fidelity and surety liability involving Seabury & Smith, Inc., National Union Fire Insurance Company of Pittsburgh, PA, and the American Insurance Company. (CP 1-16). The plaintiffs (Thomas and Marlene Cacciola, Peter and Lena Vetrano, and Wallace and Janet Rudolph) are former investor customers of Kochcapital, Inc. ("KI"), a stock brokerage which was expelled from NASD membership in SEA-535

on September 28, 1990, and fined $244,000 with rescission orders of $232,000 for violations of SEC Rule 15c2-6, the "cold call" rule. (CP 345-71). This decision was affirmed by the NASD and by the SEC in January 1991 and December 1992. (CP 372-83; CP 384-96).

KI has also been the subject of federal injunctive proceedings brought by the SEC for transactions in designated securities ("penny stocks") in violation of the Securities Exchange Act of 1934, 15 U.S.C. § 78o(c)(2), and Rule 15c2-6 thereunder. (CP 397-412). A permanent injunction was issued against KI on May 11, 1992. (CP 397-401). The securities at issue which were also purchased from KI by plaintiffs involved Genesis Capital, International Environmental Group, Unifirst Corp., Petro Plex, and other securities (CP 4-5; CP 698-703). In these securities, there were approximately 800 transactions involving more than $4 million. (CP 415-16). The injunction was effective nationally. (CP 397-401).

The claims against American, Seabury & Smith and National Union are based on plaintiffs' losses of approximately $200,000 in these securities (CP 4-10), and arise out of actions brought against KI and others in *Cacciola v. KI* and *Rudolph v. KI*. In *Cacciola v. KI*, plaintiffs obtained an assignment of rights from KI of its fidelity and surety bonds in August 1994 and October 1995. (CP 693-95). The bonds were issued by American and National Union through Seabury & Smith and the NASD fidelity & surety bond programs. (CP 679; CP 728-32; CP 34; CP 696).

In December 1999, plaintiffs effected an assignment of their rights in the bonds to the petitioner, a corporation formed to administer recovery on the rescission orders in

SEA-535, and on behalf of KI accounts in states where bonds were in place. (Appendix B).

Surety Bonds. The 2nd amended complaint, which included American as a party, was filed on January 5, 1996, and alleges that KI maintained surety bonds in the states of Oregon ($10,000), Idaho ($25,000), and Arizona ($25,000). (CP 4). Discovery with American established that KI also had surety bonds in the following states:

	STATE	AMOUNT	ISSUED	CANCELLED	ENTITY CANCEL'G
(1)	Alaska	$ 5,000	1988	Unknown	Seabury & Smith
(2)	Arizona	$ 25,000	1988	1991	" " "
(3)	Hawaii	$ 5,000	1988	1991	" " "
(4)	Idaho	$ 25,000	1988	1991	" " "
(5)	Iowa	$ 15,000	1989	1992	" " "
(6)	North Dakota	$ 25,000	1990	1991	" " "
(7)	Oregon	$ 10,000	1988	1991	" " "
(8)	South Carolina	$ 10,000	1989	Unknown	" " "

(Appendix C; CP 679, Ex. 7, pgs. 1-18). The surety bonds provided by American to KI all essentially provide that they are for the use and benefit of any person(s) having a cause of action under the laws of the states where surety bonds were issued, and that such person(s) may initiate suit in any court of competent jurisdiction against the principal and/or the surety on the bonds. (Appendix C, pgs. 7, 15 & 18).

American's motion for summary judgment motion was granted on January 31, 1997, and a motion to amend the 2nd amended complaint to assert claims on KI's surety bonds in these additional states was denied on the same date. (CP 776; CP 774; CP 734-739).

Fidelity Bonds. The NASD Rules of Fair Practice, Art. III § 32 (1990), require fidelity bond coverage of not less than 120% of net capital under SEC Rule 15c3-1. Under Rule 15c3-1(a), 17 C.F.R. 240.15c3-1(a) (1990), a securities dealer shall at all times have and maintain net capital of not less than $25,000 or $25,000 plus the sum of each broker or dealer subsidiary's minimum net capital requirement which is consolidated under 17 CFR 240.15c3-1 c.[1] Also, Rule 15c3-1 a(4) (capital requirements for market makers) must be complied with.

---

[1] The rule provides that every broker or dealer in computing its net capital shall consolidate in a single computation assets and liabilities of any subsidiary or affiliate for which it guarantees, endorses or assumes directly or indirectly the obligations or liabilities. The assets and liabilities of subsidiaries or affiliates whose liabilities and obligations have not been assumed directly or indirectly by the broker or dealer may also be consolidated if an opinion of counsel is obtained under the rule.

The claims against Seabury & Smith and National Union primarily allege negligence in failing to provide adequate fidelity bonding for KI, and in terminating its bond coverage in November 1990 when they knew or should have known that KI was operating without a bond in violation of NASD rules. (CP 13-15, 34, 39, 469 & 990).

The motions for summary judgment of Seabury & Smith and National Union relied heavily on the Declaration of James Dawson, the Associate Director of the NASD's Seattle offices. Mr. Dawson describes KI as subject to former SEC Rule 15c3-1(a)(1), that KI was required to have minimum net capital of $25,000, and that under Art. III § 32, its required fidelity coverage was $30,000. (CP 991, Ex. B). His declaration also states that the NASD has not delegated its regulatory functions with the fidelity bond rule to any outside entity, and that the NASD did not expect nor would it allow Seabury & Smith and National Union to regulate or enforce NASD members' compliance with the fidelity bond rule or net capital requirements. (CP 989, Ex. B, pgs. 3-4).

John Taylor, a retired NASD officer who oversaw the fidelity bond program in 1982, submitted a declaration for Seabury & Smith with similar statements. (CP 989, Ex. C).[2] From their declarations, Seabury & Smith and National Union argued that neither was responsible for administering or enforcing SEC and NASD rules and

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[2] Plaintiffs sought to compel Mr. Taylor's deposition on the basis that he acted in an advisory capacity to the NASD through submission of a declaration on its behalf. The motion was denied. (CP 865 & 868-69; CP 1105). This order is included in the appeal.

regulations, and that the NASD did not intend for them to have a responsibility for determining or verifying net capital and fidelity bond coverage for NASD members in the fidelity bond program. (CP 988-89; CP 1067-69).

The CR 30(b)(6) deposition of the NASD, taken on October 22, 1997, established that Mr. Dawson was not familiar with Seabury & Smith, that he had no knowledge about other providers of fidelity bonds in the securities industry, and that he didn't know whether companies that provide these bonds require audited financial statements as part of the application process. (CP 1452, Ex. 22, pgs. 26-17 & 36). Mr. Dawson testified that he was not familiar with the procedures in which fidelity bonds are issued in terms of the amount of the bond and underwriting risks. He also testified that he didn't know how companies that issue fidelity bonds calculate what the amount of a bond should be (*id.*, at pg. 38), and that he didn't know how they view broker-dealer Focus Reports in issuing fidelity bonds. (*id.*, at pgs. 37 & 43-46).

Seabury & Smith, through its CR 30(b)(6) designate and in declarations, admits that it requires underwriting information when NASD members do not meet its criteria, and that it underwrites coverage for these members – whether the risk is insurable, the conditions of coverage and the appropriate premium. (CP 1931 & Ex. A, pgs. 4-5).

In August 1997, plaintiffs sought to compel the depositions of Victor Romanov and Andrew Forstenzer of Seabury & Smith and Steve Dickson and Jon Webber of

National Union. (CP 865). The motions were denied.[3] (CP 1105). CR 30(b)(6) depositions of Seabury & Smith and National Union were taken in September and October 1997. (CP 1917-19). Through the depositions, facts surfaced showing that there is a captive entity in the fidelity bond program, the Security Dealers Insurance Company ("SDIC"), a corporation created and capitalized by the NASD, and that there are reinsurance agreements and treaties involving SDIC through which the NASD, Seabury & Smith and National Union share in the proceeds of the bond program. (CP 1346-47; CP 1295, Ex. A, pgs. 16-20; CP 1418).

Seabury & Smith and National Union take the position that the captive entity did not come into existence until 1993. (CP 1454; CP 1418; CP 1428). The concept of a

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[3] *Victor Romanov* – corporate counsel for Marsh & McLennan, assistant corporate secretary for Seabury & Smith, (CP 867 & 873, Ex. D, pgs. 1-4), and assisted in providing answers to discovery requests. (CP 87-90; CP 873, Ex. D, pgs. 1-4 & 16). *Andrew Forstenzer* – corporate counsel for Marsh & McLennan, and is responsible for overseeing the action against Seabury & Smith. (CP 873, Ex. D, pg. 7). Mr. Forstenzer filed declarations on the roles of Seabury & Smith and National Union in the fidelity bond program (CP 873-74, Ex. D, pgs. 5-10; CP 92), and also has oversight responsibilities for answers to discovery requests. (CP 874, Ex. D, pg. 16). *Steve Dickson* – associate general counsel for the American International Group ("AIG") in New York. Mr. Dickson is responsible for overseeing the action involving National Union, and is also responsible for providing answers to discovery requests. (CP 874, Ex. D, pgs. 21-23). *Jon Webber* – AIG counsel, responsibilities include oversight of fidelity bond claims for AIG and National Union. Mr. Webber is also responsible for providing answers to discovery requests. (CP 874-75, Ex. D. pg. 27).

captive in the fidelity bond program goes back to 1982 (CP 1346-47 & Ex. J), and Richard Lagani, National Union's CR 30(b)(6) designate, testified that the contracts involving SDIC change on a yearly basis. Mr. Lagani also testified that he did not know when the captive was formed or whether a captive might have existed prior to 1993, and he testified that there are in fact contracts between SDIC and National Union. (CP 1330 & Ex. B, pgs. 3, 5 & 6).

Motions to compel production of documents from Seabury & Smith and National Union relating to contracts and business agreements between Seabury and Smith, National Union, and the NASD, including the SDIC, records of corporate meetings and minutes of meetings for SDIC, and reinsurance agreements and treaties involving SDIC, Seabury & Smith, National Union and the NASD were filed by plaintiffs. (CP 1295; CP 1330; CP 1345). The motions were denied. (CP 1447). A motion for reconsideration (CP 1449) included: (1) financial statements and FOCUS reports for KI (6/89-1/91); (2) excerpts from the deposition of James Dawson; (3) documentation from Seabury & Smith and National Union competitors (CNA, ITT Hartford & Travelers); and (4) Declarations from Don W. Jones. (CP 1763, Ex. 24; CP 1833).

In his declaration, Don Jones stated that he was employed by Kochcapital at its main offices in Washington, and that he was the head compliance officer for the main office and KI's branch offices. He stated that he had seen the EOM Trading Reports, and knew that KI made a market in about 75% of the securities in these reports. He also stated that he had seen the financial statements for KI in Exhibits 1 and 2, and that KI's trading revenues in

1989 and 1990 were based on gross trading revenues for its main office and its branch offices. (CP 1763, Ex. 24).

The fidelity applications for CNA, ITT Hartford and Travelers Property Casualty are the same, "Application for a Financial Institution Bond, Standard Form No. 14 for Broker/Dealers." (CP 1452-53 & Ex. 23, pgs. 1-19). Seabury & Smith and National Union also use the Standard Form No. 14 for Broker/Dealers. (CP 1917, Deposition of K. Jacobson, pgs. 91, 130-31; CP 1917, Deposition of R. Lagani, pgs. 7374). SEC Rule 15c3-1 is incorporated as part of the Form 14 standard bond form. (CP 1917, Deposition of K. Jacobson, pgs. 121-22).

The summary judgment motions of Seabury & Smith and National Union were granted on December 5, 1997. (CP 1831; CP 1827). The motion for reconsideration on the motions to compel was denied on January 16, 1998. (CP 1942). Judgments were entered in their favor in January 1998 and February 1998. (CP1948; CP 1952). In August and November 1998, stipulated motions to dismiss on the fidelity bond claims were filed with the Court of Appeals.

V. AUTHORITIES & ARGUMENT

A. PRINCIPAL & SURETY ACTIONS. American raised the issue in its reply on its summary judgment motion that a principal may not maintain suit against a surety on a surety bond issued by the surety on behalf of the principal. The basis for dismissal is not clear from the summary judgment order, but the Court's opinion in the affirmance of the order states the question whether a principal on a surety bond may also be an obligee such that it may sue the surety to recover the amount of the

bond(s). (Appendix A, pg. 6). Siding with American and the trial court, the Court of Appeals held that the general rules of suretyship law do not allow a principal to sue a surety under the terms of the bonds issued by American. (*id.*). This position is not supported by case law, and the authorities clearly hold otherwise:

> *When the surety is sued by the principal on a claim held by the latter against the former, the mere fact of the suretyship will not be a defense to the surety if no action has been taken against him on the debt for which he is a surety,* nor will it be a defense against the personal representative of the principal, and it has been held that the surety cannot refuse to pay claims which have been assigned to the principal if the surety has not paid anything on the debt for which he is liable. . . .
>
> The principal has the *right to assign* to the creditor, as security, a debt due from the surety to the principal, but an oral agreement between the principal and the surety that a debt of the latter to the former shall go in satisfaction of the liability about to be assumed by the surety will not prevail over an oral assignment of the debt by the principal to a third person before the surety became bound. (italics and underscoring added).

72 C.J.S. Principal and Surety § 226, pg. 352 (1987).

These principles are supported by established case law, and are clearly permissive of principal rights to maintain suit against the surety on a surety bond. *See Root v. Moriarty*, 39 Ind. 85 (S.Ct. Ind. 1872) (Moriarty contracted to perform work in the improvement of a city street; Root was Moriarty's surety on a bond for the

performance of the work. In a suit brought by Moriarty against Root, the Court held that Root should pay and satisfy all indebtedness of Moriarty based on the improvements. It was also determined that Moriarty, to whom certain claims for labor in making the improvements had been assigned, could maintain suit against Root on the assigned claims); *Miller v. Cherry*, 57 N.C. 193 (S.Ct. N.C. 1858) (where a surety is liable for several different debts of the principal, the latter has the right to assign a debt due him by his surety for the security of any debt he may think proper); *Municipal Court v. Whaley*, 55 A. 750 (S.Ct. R.I. 1903) (executor as principal on a joint and several bond may maintain action against coexecutor and sureties for the default of his coexecutor-coprincipal; *Carpenter v. Park*, 19 Cal. App. 2d 567, 66 P.2d 224 (1937) (in action against partners of a stock brokerage firm to recover on a note, court properly permitted partner to file cross-complaint against surety who had promised to pay note in the event of a default by partnership); *First Virginia Bank v. Baker*, 301 S.E.2d 8 (S.Ct. Va. 1983) (a creditor's right to proceed against the surety exists independently of his right to proceed against principal).

The Court of Appeals misconstrues the heart of the issue in this case. Contrary to the Court's holding, petitioner is not seeking to substitute as an obligee in place of the principal on the bonds, but rather, is proceeding in the principal's place as representative on the rescission orders and fines in SEA-535, and on accounts maintained by the principal between 1988 and 1991 in states where bonds were in place. It is well established that corporations have the right to sue and be sued as natural persons, *Pac. Amer. Realty Trust v. Lonctot*, 62 Wn.2d 91, 95,

381 P.2d 123 (1963), and the concept of a corporation as a separate entity is an established legal principle. *Modern Pioneers Insurance Company v. Nandin*, 437 P.2d 658, 663 (Ariz. 1968).

The Court itself cites *Schmitt v. Insurance Co. of North America*, 230 Cal.App. 3d 245, 281 Cal.Rptr. 261 (1991), a case involving an action by purchasers of a motor vehicle and the dealership as principal on a used-car dealer's bond against the surety (Insurance Company of North America) for tortious breach of the covenant of good faith and fair dealing in violation of California Insurance Code § 790.03.

The Restatement of Suretyship and Guaranty recognizes principal rights of action against the surety in this relationship. Section 22, Comment a, Illustration 1 provides by example: S becomes surety to C at P's request upon P's bond for $5,000. At the maturity of the bond, P refuses to pay. C thereupon sues S, who defends the suit unsuccessfully after giving P an opportunity to defend. S then pays the amount of C's judgment. P has a duty to reimburse S. Restatement (Third) of Suretyship and Guaranty § 22 (1995). By analogy, S is American, KI is C, and the state may be P. The difference here is that the bonds run to the state, and are posted by C, the broker-dealer, as required by P.

State, Healy v. Maryland Casualty Co., 557 P.2d 258 (Or. App. 1976), comes within the theory of this example. In *State, Healy*, the state brought an action against the sureties (Maryland Casualty Co. and United Pacific Insurance Co.) of Pacific Securities Co., a bankrupt broker-dealer, to

recover on surety bonds posted by the broker. The Oregon Court of Appeals held that the state came within ORS 59.115, which provides that any person having a right of action against a brokerdealer under this section has a right of action on the bond required under ORS 59.175. The Court also held that the state could sue on the bonds and could recover on the bonds. *State, Healy,* 557 P.2d at 260-62.

Commentators have also written about rights of action between the surety, the principal and the obligee and case law on this relationship:

> The surety's duty to the principal derives from the underlying contractual relationship. *The surety agreement contains an implied covenant of good faith and fair dealing, as does any contract.* . . .
>
> A surety's breach of the duty of good faith to the principal may give rise to tort liability and punitive damages. . . .
>
> Regardless of whether a breach gives rise to tort or contract damages, the surety has a duty of good faith to the principal. . . . The surety's good faith duty to the principal precludes the surety from interfering with the contract between the principal and the obligee. *Any unwarranted interference may subject the surety to a discharge of indemnity rights against the principal or a claim for tortious interference with contractual relations.*
>
> Typically, an obligee disputes performance with the principal before pursuing the surety. . . . Because the principal often can determine the merit of the underlying claim, the principal is the first party that a surety would contact to

> ascertain the nature of the claim. . . . *[I]f the surety denies the claim after meeting with the principal, the obligee may assert a bad faith action against the surety no matter how frivolous the [action]. [I]f the surety immediately pays a claim after meeting with the principal, the principal may bring an action against the surety for discharge of indemnity rights or tortious interference with contractual relations.* (citations omitted, italics added).

Udelman, *Surety Contractors: Are Sureties Becoming General Liability Insurers*, 22 Ariz. St. L. J. 469, 471-485. (1990); *see also Cushman v. National Surety Corp. of New York*, 4 Ariz. App. 24, 417 P.2d 537, 540-41 (1966) (action by principals against surety, the Court holding in part that surety agreements are to be construed so as to impose on the surety the obligation of acting in good faith).

American concedes that a surety has liability to an obligee (creditor) if the principal fails to pay the obligee (Brief, pg. 5), and also states that under an indemnity agreement between KI and itself, it has a right of indemnity and exoneration. (*id.*, pg. 9). Surety contracts, however, are construed most strongly against the surety, and in favor of the insured. Couch, *Cyclopedia of Ins. Law*, Volume 11 § 44:6 (1982).

The surety bonds provided by American to KI all provide that they are for the use and benefit of any person having a cause of action under the laws of the states where bonds were issued, and that such person may initiate suit in any court against the principal and/or surety upon the bond. (Appendix C, pgs. 7, 15 & 18). The rule of construction of these provisions in the bonds

issued by American to its insured leads to one conclusion. Under clear bond language, principal insured actions against the surety are permitted by the express language of the bonds.

Damages and liability in this case became certain by the rescission orders of $232,000 in SEA-535. The evidence shows that KI was not financially able to comply with the orders in SEA-535 (CP 399-400), and there is no showing in the record that these orders have been complied with. As American concedes in its brief, a surety has liability to an obligee (creditor) if the principal fails to pay the obligee, and thus, when KI could not pay on the orders in SEA 535, claims which are no doubt covered by the bonds, its liability, as surety, to these creditors was established. It is this liability, including claims on accounts in states where bonds were in place, that is being enforced under bond provisions, and there are no precedents or principles of law that prevent this.

There are important reasons why review of this action should be accepted. First, the issue of whether an action maybe maintained by an insured principal against a surety on bonds issued by the surety is an issue of substantial public interest involving claims of $4 million in states where bonds were in place. Rescission orders of $232,000 are also involved, claims which are clearly covered by the bonds in this case. Also important, are the legal questions raised by the application of surety principles to these facts. These questions are not answered in *Honey v. Davis*, 131 Wn.2d 212, 930 P.2d 908 (1997), and *Seattle First Nat. Bank v. Washington Ins. Guar. Ass'n*, 116 Wn.2d 398, 804 P.2d (1991), but have been answered positively by the courts of a number of other states.

The decision cannot be reconciled with these cases, and implicates equal protection principles in the application of the law to this case. *Lindsey v. Normet*, 405 U.S. 56, 77 (1972) ("When an appeal is afforded . . . it cannot be granted to some litigants and capriciously or arbitrarily denied to others without violating the Equal Protection Clause."); *Demorest v. City Bank Co.*, 321 U.S. 36, 42-43 (1944) ("Even though the constitutional protection invoked [is] denied on non-federal grounds, it is the province of this Court to inquire whether the decision of the state court rests upon a fair or substantial basis."). The Court's grant of an immunity to American in this case runs counter to case law and practice manuals on principal rights of action against the surety.

B. Seabury & Smith & National Union.

1) *Policy and Fidelity Bond Assignments.* In Washington, rights under fidelity bonds are generally assignable. *Estate of Jordan v. Hartford Co.*, 120 Wn.2d 490, 495-96, 844 P.2d 403 (1993). As assignees of the fidelity bonds, plaintiffs (and petitioner) have standing to assert direct actions against Seabury & Smith and National Union. *Id.*

An issue of substantial public interest is whether the investing public is the beneficiary of a fidelity bond. The bond in this case is not a bond that is required by the express terms of RCW 21.20, *et seq.*, but it is required by the NASD Rules of Fair Practice, Art. III § 32 (1990).

Like RCW 18.44, *et seq.*, underlying the fidelity bond rule and the net capital rule is a policy that these rules are designed to protect the public. *Foster v. National Fire Insurance Co.*, 902 F.2d 1316, 1320 (8th Cir. 1990) (public

policy underlying Arkansas Securities Act is that investing public is the beneficiary of a fidelity bond); *Shields v. National Union Fire Insurance Co.*, 153 B.R. 677, 684 (E.D. Pa. 1993) (public policy on the intended beneficiaries of NASD fidelity bond and the necessity for obtaining fidelity insurance is well founded); *Kehoe v. Peerless Insur. Co.*, 1980 WL 1425 (D. Mass. 1980) (Investment Co. Act of 1940 and SEC rules which required fidelity bonding enacted to protect shareholders; *Lamb Brothers, Inc.*, 46 S.E.C. 1053, 1060 (1977) (the net capital rule is designed to protect brokerage customers). The policies underlying statutes and regulations in these and other cases are uniform in holding that these bonds should be liberally interpreted to carry out their purpose, the protection of the investing public.

In *Estate of Jordan*, the Court affirmed a long standing policy in this area, "[f]idelity bonds, being contracts of indemnity against loss, are to be liberally construed in favor of the object sought to be obtained." There are no Washington cases interpreting RCW 21.20, *et seq.*, on this issue, but the Securities Act and state regulations (WAC 460-21 B-060 § 24 and 460-22B-090 § 19, incorporate NASD Rules), support this purpose. *Hines v. Data Line Systems*, 114 Wn.2d 127, 145, 787 P.2d 8 (1990). An interpretation of the Securities Act with a view to the policy in these cases holding the investing public as the intended beneficiary of the NASD fidelity bond is in the public interest and is consistent with state law.

A more difficult issue of substantial public interest is the language of the bond which does not allow for direct rights of action by third parties. The question is whether

this language of the bond conforms with established policy under Washington law.

Some of the plaintiffs were able to obtain an assignment of fidelity bond rights from KI for their claims, but others (*i.e.*, Rudolphs) proceeded with claims on the bond without an assignment. The former are seemingly protected by the assignment, but the latter are without this protection because of exclusionary bond language.

In *Foster*, the 8th Circuit stated, " . . . it is clearly the public policy in Arkansas to protect the investing public. . . . " 902 F.2d at 1319. The same public policy exists in Washington. *Hines*, 114 Wn.2d at 145. *"[It] appears to be such a strong theme throughout the statutes and rules that when viewed in conjunction with the requirement that a broker/dealer maintain a bond that any limiting or exclusionary provisions . . . which would not afford such protection to the public would be void as against public policy or disregarded."* 902 F.2d at 1319.

In Washington, limitations in insurance policies which are contrary to public policy will also not be enforced. *Brown v. Snohomish Cy. Physicians Corp.*, 120 Wn.2d 747, 753, 845 P.2d 334 (1993); *State Farm General Ins. Co. v. Emerson*, 102 Wn.2d 477, 481, 687 P.2d 1139 (1984). As in *Foster*, the intent of the Washington Securities Act and established policy underlying the fidelity bond and net capital rules is circumvented by bond language that prevents a right of direct action by third parties on the bond. Bond language that does not allow for direct suit by third parties or cover their losses in the absence of the insured's consent circumvents state law,

violates established public policy and should be disregarded.

2) *Discovery Orders.* Motions to compel on document requests for contracts and business agreements between Seabury & Smith, National Union and the NASD, including the Security Dealers Insurance Company, records of corporate meetings and re-insurance agreements and treaties involving SDIC, Seabury & Smith, National Union, and the NASD should have been ordered in this case. *See* CR 26(b)(1); *Bushman v. New Holland Division*, 83 Wn.2d 429, 434, 518 P.2d 1078 (1974).

The phrase, "relevant to the subject matter involved in the pending action," has been construed broadly to encompass any matter that bears on, or that reasonably could lead to other matter that could bear on, any issue that is or may be in the case. *Oppenheimer Fund, Inc. v. Sanders*, 437 U.S. 340, 351 (1977) (citing *Hickman v. Taylor*, 329 U.S. 495, 501 (1947)).

The motions for summary judgment of Seabury & Smith and National Union were based on the working relationship and roles between themselves and the NASD in the fidelity bond program, but they refused to produce any documentation in response to discovery requests that could shed light on this relationship. Under CR 26(b), the information sought is reasonably calculated to lead to the discovery of admissible evidence, and it is clear that this relationship cannot be discovered or defined until these documents are produced.

3) *Fidelity Coverage.* A final issue of substantial public interest and probably the most important issue in this part of the case, concerns the fidelity coverage that was

provided to KI by its fidelity insurers. Contrary to the positions of Seabury & Smith and National Union, the evidence shows that a fidelity bond of approximately $300,000 should have been issued in this case. The importance of obtaining appropriate fidelity coverage for broker-dealers in dealings with the public is clear.

The Supreme Court should decide the issues that concern Seabury & Smith and National Union because the issues are of continuing and substantial public interest in Washington, and across the country. *See Purchase v. Meyer*, 108 Wn.2d 220, 229-30, 737 P.2d 1005 (1987); *Save Our Park v. Hordyke*, 71 Wn. App. 84, 88-89, 856 P.2d 734 (1993). The impact of a decision on these issues shows that the public, and approximately 1000 former public customers of KI, if not more, will be affected by a decision on these questions. There is a need for a determination of these issues particularly in the guidance of judges that are faced with these issues, and also for lawyers in Washington and across the country that must advise their clients in these areas.

VI. CONCLUSION

For the foregoing reasons, the petitioner respectfully requests that the Supreme Court accept review of this case. The decisions below should be reversed and remanded to the trial court.

Dated: April 28, 2000.

Respectfully submitted,

/s/ John M. Keefe
John M. Keefe,
WSBA 18371
Attorney for Petitioner

APPENDIX B

IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON

DIVISION II

KOCHCAPITAL, INC., a Stock Brokerage firm; THOMAS CACCIOLA and MARLENE CACCIOLA, husband and wife; PETER VETRANO and LENA VETRANO, husband and wife; and WALLACE RUDOLPH and JANET RUDOLPH, husband and wife,

Appellants,

v.

SEABURY & SMITH, INC., a Delaware corporation; NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PA, a Pennsylvania corporation,

Defendants,

AMERICAN INSURANCE COMPANY, a Nebraska corporation,

Respondent.

No. 22670-7-II

consolidated with:

No. 22785-1-II

UNPUBLISHED OPINION

Filed:
FEB 25 2000

HOUGHTON, J. – Thomas and Marlene Cacciola, Peter and Lena Vetrano, and Wallace and Janet Rudolph (referred to collectively as plaintiffs) appeal the summary judgment dismissal of their fidelity and surety liability claims against Seabury & Smith, Inc., National Union Fire

Insurance Company, and American Insurance Company. We affirm.

FACTS

In August 1995, the plaintiffs filed a lawsuit against Seabury & Smith, Inc. (S & S), National Union Fire Insurance Company (National Union), and American Insurance Company (American) in Pierce County. Characterizing the action as one of fidelity and surety liability, the plaintiffs' second amended complaint alleged four claims: (1) professional malpractice against S & S, (2) breach of contract against S & S and National Union, (3) negligence against S & S and National Union, and (4) surety bond liability against American.

The lawsuit stemmed from the plaintiffs' investment losses in the late 1980s and early 1990s with Kochcapital, Inc. (Kochcapital), a Bellevue-based stock brokerage dealer that specialized in trading low-priced stocks. During the time in which plaintiffs invested with Kochcapital, the firm was expelled from National Association of Securities Dealer (NASD) membership and fined $244,000 for violations of SEC Rule 15c2-6, 17 C.F.R. sec. 240.15c2-6 (1990), the "cold call" rule.[1] Altogether, the plaintiffs invested and lost nearly $200,000 with Kochcapital.[2]

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[1] On May 12, 1992, a permanent injunction was issued against Kochcapital, forbidding it from further securities dealings.

[2] The Rudolphs allegedly invested nearly $58,000 with Kochcapital's Washington office, while the Cacciolas and Vetranos each invested between $60-70,000 with a Florida branch office.

Plaintiffs' losses and their discovery of Kochcapital's NASD expulsion spawned two separate securities fraud actions in King County – *Rudolph v. Kochcapital, Inc., et al.* and *Cacciola/Vetrano, et al. v. Kochcapital, Inc., et al.* In July 1992, Rudolph obtained a $35,000 arbitration award for conversion against Russell Koch, president of Kochcapital. Meanwhile, the Cacciolas and Vetranos obtained a joint and several default judgment of $251,379.07 in October 1995 against Kochcapital and officers in two other companies. In the same action, the Cacciolas and Vetranos sued, among others, S & S and National Union. National Union settled. Summary judgment was granted to S & S.

In settling the King County action against Kochcapital, the Cacciolas and Vetranos obtained a complete assignment of Kochcapital's rights in its fidelity and surety bonds.[3] As stated in plaintiffs' pleadings, Kochcapital's assignments of its rights under fidelity and surety bonds purchased from National Union and American through S & S formed the basis of plaintiffs' Pierce County action.

On December 5, 1997, plaintiffs' claims against S & S and National Union were dismissed on summary judgment.[4] Following an appeal to this court, plaintiffs entered into stipulated motions to dismiss the appeal against both S & S and National Union.

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[3] The fidelity bonds' assignment was executed on August 31, 1994. The surety bonds' assignment was executed on November 15, 1995.

[4] Attorney fees were also awarded to both S & S and National Union for plaintiffs' pursuit of a frivolous action.

In late 1996, American moved for summary judgment on plaintiffs' surety bond liability claim, asserting that although it had underwritten surety bonds for Kochcapital in Oregon, Idaho, and Arizona, as plaintiffs alleged, none of the plaintiffs' claims arose in those states. The plaintiffs responded that they were not asserting direct claims against American as obligees on the bonds but, rather, they were standing in the shoes of Kochcapital, as assignees. To that end, the plaintiffs asserted that American was liable to Kochcapital on the surety bonds, stating that Kochcapital's agents had violated Oregon, Idaho, and Arizona securities law through violations of the NASD's "cold call" rule, which resulted in the imposition of a $244,000 fine and loss of the ability to conduct business in those three states. Plaintiffs stated that this resultant harm qualified Kochcapital, under the terms of the surety bonds, to bring a cause of action against American, the surety. And, as assignees, plaintiffs were now bringing the cause of action that Kochcapital could have brought. American replied that it had not assumed any obligation to Kochcapital in underwriting the surety bonds, and that the law simply did not allow a principal to sue its surety on a surety bond.

On January 31, 1997, following plaintiffs' counsel's non-appearance, the trial court entered summary judgment for American. Plaintiffs filed a motion for reconsideration, requesting an additional hearing. In its motion, plaintiffs reiterated that its claims against American were based upon Kochcapital's assignment of its rights under the surety bonds and that plaintiffs believed Kochcapital possessed a cause of action against American under the terms of the bonds. The trial court granted an

additional hearing, noting that due to counsel's non-appearance it had treated the matter as abandoned rather than adjudged the case on its merits.

At the hearing, American stated that it was clear the plaintiffs had abandoned their pleaded direct claims theory of recovery and were now suing only on the assignment. Plaintiffs disputed that they had ever pleaded direct claims, stating that they had been depending upon the assignment all along. Following the hearing, the trial court granted American's motion for summary judgment to American, emphasizing that allowing a principal to sue a surety on the surety bond, as plaintiffs requested, would turn suretyship law on its head.

The trial court also denied plaintiffs' request to amend their second amended complaint to add claims on surety bonds that Kochcapital maintained in five other states. Upon a concession from plaintiffs that the amended claims would proceed on the same theory as the current claims, the trial court denied the motion to amend on grounds that it was futile.

Plaintiffs appeal the trial court order granting summary judgment and denying leave to file a third amended complaint.

ANALYSIS

A. State Surety Bond Liability: Claims against American[5]

Plaintiffs first contend that the trial court erred in granting summary judgment on their claims against American, arguing that the surety bonds cover their asserted claims.

When reviewing an order of summary judgment, this court engages in the same inquiry as the trial court. *Wilson v. Steinbach*, 98 Wn.2d 434, 437, 656 P.2d 1030 (1982). Summary judgment is appropriate only if the pleadings, affidavits, depositions, and admissions on file demonstrate the absence of any genuine issues of material fact, and that the moving party is entitled to judgment as a matter of law. CR 56(c). We consider all facts submitted and all reasonable inferences from them in the light most favorable to the nonmoving party. *Wilson*, 98 Wn.2d at 437.

Plaintiffs admit that their claims against American are based upon Kochcapital's assignments of its surety bonds. Plaintiffs assert that Kochcapital has a cause of action against American, as surety, under the terms of each state bond. Plaintiffs argue that (a) Kochcapital's agents violated the securities laws of Oregon, Idaho, and

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[5] Plaintiffs also contend that the trial court erred in granting summary judgment for S & S and National Union and in denying plaintiffs' motions seeking to compel production of documents from S & S and National Union. We decline to review these alleged errors as the plaintiffs' appeal with regard to these two parties has been voluntarily dismissed with prejudice.

Arizona when they violated NASD's "cold call" rule, which resulted in the imposition of $244,000 in fines to Kochcapital and the loss of ability to do business in those states; and (b) that harm qualifies Kochcapital, under the terms of the surety bonds, to sue American, as surety, for the amount of the bonds.[6] American counters – and the trial court agreed – that fundamental suretyship law simply does not allow a principal to sue a surety under the terms of the bond.

The three state surety bonds issued by American are markedly similar. Each bond identifies Kochcapital as the principal, American as the surety, and provides that American shall pay the amount of the bond to any person suffering damages due to Kochcapital's, or its agents', violation of state securities law.[7]

Thus, the question presented is whether a principal on a surety bond may nevertheless also be an obligee such that it may sue the surety to recover the amount of the bond. The answer is no.

Every surety bond involves a three-party relationship: (1) "Principal", a.k.a. promissor, debtor or obligor, who is the party obligated under the original contract; (2) "Obligee", a.k.a. promisee, creditor or beneficiary, who is the person for whose benefit the bond is given; and (3) "Surety", who is the party who binds itself to the obligee,

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[6] Plaintiffs acknowledge that Kochcapital never paid the $244,000 fine.

[7] Each bond was entered under a state law requiring broker-dealers to post a surety bond. Washington does not have a similar requirement. Hence, no bond was executed in Washington.

guaranteeing the principal's obligations in exchange for a premium and the principal's promise to indemnify the surety for any loss. See 3 LEE R. RUSS & THOMAS F. SEGALLA, COUCH ON INSURANCE § 11:14 at 26 (3d. ed. 1995); see RESTATEMENT (THIRD) OF SURETYSHIP AND GUARANTY § 1 (1995).

Coverage under a surety bond involves principles quite different from those governing insurance contracts generally, including the parties protected. Whereas an insurance policy protects the owner or beneficiary of the policy, a surety bond is expressly for the protection of a third person (the obligee) to whom the principal is obligated and who may be damaged should the principal fail to perform. *Lumbermens Mut. Cas. Co. v. Agency Rent-A-Car, Inc.*, 128 Cal.App.3d 764, 769, 180 Cal.Rptr. 546 (1982). Indeed, "it is not the duty of the surety to protect the principal . . . [t]he surety's duty runs to the third party obligee. . . . " *Schmitt v. Insurance Co. of N. Am.*, 230 Cal.App.3d 245, 258, 281 Cal.Rptr. 261 (1991). This is exemplified by the fact that if a surety is compelled to make payment for damages caused by its principal, the surety has the right to seek reimbursement from the principal. Thus, the ultimate risk of loss remains with the principal. *Honey v. Davis*, 131 Wn.2d 212, 217-18, 930 P.2d 908 (1997).

Given the general rules of suretyship law, it does not make sense that the ultimate burden and benefit reside in the same place. If an obligee and principal were allowed to be the same, the result would be that the obligee would

recover from the surety, who would in turn recover from the principal, i.e., the obligee.[8],[9]

Finally, we address the status of the Rudolphs' appeal. As noted, plaintiffs disavow that they are asserting direct claims against American as obligees under the surety bonds. Consequently, as counsel conceded at oral argument, the Rudolphs do not have standing in this appeal, as they were not assignees of Kochcapital's surety bond rights. Counsel argues that the Rudolphs could easily be added as assignees. Even assuming that is possible, the Rudolphs' claims against American based upon the assignment would fail for the same reasons iterated above.

B. Motion to Amend

Plaintiffs also contend that the trial court erred in denying their motion to amend their second amended complaint to add claims on surety bonds that Kochcapital maintained in five other states. We review the trial court's denial of a motion to amend a complaint for manifest abuse of discretion. *McDonald v. State Farm Fire & Cas.*

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[8] We note that the terms of the Arizona bond mandate this conclusion with respect to Kochcapital's right to sue as obligee under that bond, which provides that the bond's beneficiaries are any person who shall have a cause of action against the principal. Here, Kochcapital cannot have a cause of action against itself.

[9] At oral argument, counsel asserted that the claims were filed within the statute of limitations in Oregon, Idaho and Arizona. Even assuming this is true, plaintiffs' arguments still fail.

Co., 119 Wn.2d 724, 737, 837 P.2d 1000 (1992). It is not an abuse of discretion to deny a motion for leave to amend when the proposed new claim would be futile. *Doyle v. Planned Parenthood*, 31 Wn.App. 126, 132, 639 P.2d 240 (1982). Here, plaintiffs admitted that the proposed additional claims would proceed on the same theory as the current claims. Thus, if the amendment had been allowed, the amended complaint would have been subject to summary judgment for the same reasons as the current complaint. Hence, allowing the amendment would have been futile and was properly denied.

The trial court did not err in entering summary judgment orders dismissing plaintiffs' claims and in denying their motion to amend the second amended complaint.

Affirmed.

A majority of the panel having determined that this opinion will not be printed in the Washington Appellate Reports, but will be filed for public record pursuant to RCW 2.06.040, it is so ordered.

/s/ Houghton, J.
Houghton, J.

We concur:

/s/ Bridgewater, C.J.
Bridgewater, C.J.

/s/ Armstrong, J.
Armstrong, J.

APPENDIX C

IN THE SUPERIOR COURT FOR THE
STATE OF WASHINGTON
FOR PIERCE COUNTY

KOCHCAPITAL; THOMAS CACCIOLA AND MARLENE CACCIOLA; PETER VETRANO and LENA VETRANO; and WALLACE RUDOLPH and JANET RUDOLPH,

Plaintiffs,

v.

SEABURY & SMITH, INC., NATIONAL UNION FIRE INSURANCE CO., and AMERICAN INSURANCE CO.,

Defendants

Cause No. 95-2-09591-2

ORDER DENYING PLAINTIFFS' MOTION TO AMEND SECOND AMENDED COMPLAINT

(Filed
Jan. 31, 1997)

THIS MATTER coming on for hearing before the undersigned Judge of the above-captioned Court upon Motion of Plaintiffs for Leave to Amend its Second Amended Complaint, and the Court having considered the records and files herein, ~~the arguments of counsel~~ [Plaintiffs did not appear /s/ TJF], and being otherwise fully advised in the premises, now, therefore,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED that Plaintiffs' Motion to Amend is hereby denied.

DONE IN OPEN COURT this 31 [/s/ TJF] day of Jan., 1997

/s/ Thomas J. Felnagle
JUDGE

Ulin Lambe & Hicks, P.S.
Attornes at Law
1501 Fourth Ave., Suite 2180
Seattle, Washington 96101
(206) 624-4848

ORDER DENYING PLAINTIFFS' MOTION TO AMEND SECOND AMENDED COMPLAINT-1

Presented by:

ULIN LAMBE & HICKS

By /s/ Richard L. Lambe
Richard L. Lambe
WSB No. 9320
Attorneys for The American Insurance Company

Copy received and approved as to form by:

By Did not appear
John M. Keefe
WSB No. 18371
Attorneys for Plaintiffs

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IN THE SUPERIOR COURT FOR THE STATE OF WASHINGTON FOR PIERCE COUNTY

KOCHCAPITAL; THOMAS CACCIOLA AND MARLENE CACCIOLA; PETER VETRANO and LENA VETRANO; and WALLACE RUDOLPH and JANET RUDOLPH, Plaintiffs, v. SEABURY & SMITH, INC., NATIONAL UNION FIRE INSURANCE CO., and AMERICAN INSURANCE CO., Defendants	Cause No. 95-2-09591-2 ORDER GRANTING MOTION FOR SUMMARY JUDGMENT (Filed Jan. 31, 1997)

THIS MATTER coming on for hearing before the undersigned Judge of the above-captioned Court upon Motion of The American Insurance Company Motion for Summary Judgment, and the Court having considered the records and files herein, ~~the arguments of counsel~~ [Plaintiffs did not appear /s/ TJF], the Declarations of James E. Willis, Richard L. Lambe, Peter Vetrano, and Thomas A. Cacciola, and being otherwise fully advised in the premises, now, therefore,

IT IS HEREBY ORDERED, ADJUDGED AND ~~DE~~CREED that The American Insurance Company's

Motion for Summary Judgment is hereby granted, and The American Insurance Company is dismissed with prejudice. The American Insurance Company will recover its costs from Plaintiffs according to its cost bill to be filed.

DONE IN OPEN COURT this 31 [/s/ TJF] day of Jan., 1997

/s/ Thomas J. Felnagle
JUDGE

Presented by:

ULIN LAMBE & HICKS

By /s/ Richard L. Lambe
Richard L. Lambe
WSB No. 9320
Attorneys for The American Insurance Company

Copy received and approved as to form by:

By Did not appear
John M. Keefe
WSB No. 18371
Attorneys for Plaintiffs

h\08\0861007d

IN THE SUPERIOR COURT FOR THE
STATE OF WASHINGTON
FOR PIERCE COUNTY

KOCHCAPITAL; THOMAS CACCIOLA AND MARLENE CACCIOLA; PETER VETRANO and LENA VETRANO; and WALLACE RUDOLPH and JANET RUDOLPH, Plaintiffs, v. SEABURY & SMITH, INC., NATIONAL UNION FIRE INSURANCE CO., and AMERICAN INSURANCE CO., Defendants	Cause No. 95-2-09591-2 ORDER DENYING MOTION FOR RECONSIDERATION

THIS MATTER coming on for hearing before the undersigned Judge of the above-captioned Court upon Plaintiffs' motion to reconsider the Order Denying Plaintiffs' Motion to Amend Second Amended Complaint and the Order Denying Motion for Summary Judgment, both entered on January 31, 1997, and the Court having considered the records and files herein, the arguments of counsel, and being otherwise fully advised in the premises, now, therefore.

IT IS HEREBY ORDERED, ADJUDGED AND DECREED that Plaintiffs' Motion for Reconsideration is denied.

DONE IN OPEN COURT this ___ day of _____, 1997

_____
JUDGE

Presented by:

ULIN LAMBE & HICKS

By _____
Richard L. Lambe
WSB No. 9320
Attorneys for The American Insurance Company

Copy received and approved as to form by:

By _____
John M. Keefe
WSB No. 18371
Attorneys for Plaintiffs

H\08\0870303B.WPD

IN THE SUPERIOR COURT OF WASHINGTON
FOR PIERCE COUNTY

KOCHCAPITAL, INC., a Stock Brokerage Firm; THOMAS CACCIOLA and MARLENE CACCIOLA, Husband and Wife; PETER VETRANO and LEAN [sic] VETRANO, Husband and Wife; and WALLACE RUDOLPH and JANET RUDOLPH, Husband and Wife, Plaintiffs, v. SEABURY & SMITH, INC., a Delaware corporation; NATIONAL UNION FIRE INSURANCE CO. OF PITTSBURGH, PA, a Pennsylvania corporation; and JOHN DOES and JANE DOES 1-50, Defendants.	NO. 95-2-09591-2 ORDER ~~AND JUDGEMENT~~ [DENYING PLAINTIFFS' MOTION TO COMPEL AND GRANTING TERMS TO DEFENDANTS AND TO NASD]

THIS MATTER came before the court on plaintiffs' motion and certification to compel depositions. The Court has considered plaintiffs' motion and certification and the exhibits thereto, as well as the responsive pleadings filed by Seabury & Smith, Inc., National Union Fire Insurance

Co. of Pittsburgh, and the National Association of Securities Dealers, Inc.

THE COURT FINDS that Seabury & Smith[, National Union, and the NASD] [/s/ TJF] has exercised good faith in responding to plaintiffs' requests to take depositions, ~~that plaintiffs' attorney failed to confer with counsel for Seabury & Smith prior to bringing this motion~~, and that plaintiffs' motion to compel is not substantially justified ~~insofar as it relates to Seabury & Smith.~~ [. Plaintiffs' motion is denied.] [/s/ TJF] The Court further finds that counsel for Seabury & Smith[, National Union, and the NASD each] ~~has~~ [/s/ TJF] incurred reasonable attorney fees of $500 in defending this motion. ~~Based on the foregoing, and pursuant to CR 26(i) and CR 379a, the Court awards Seabury & Smith judgment in the amount of against plaintiffs' attorney, Mr. John Keefe.~~ [, and shall recover the same from Plaintiffs and Plaintiffs' counsel. Counsel for all parties and the NASD shall confer within the next 7 days regarding scheduling and coordination of CR 30(b)(6) depositions. /s/ TJF]

DATED this 5th day of September, 1997.

/s/ Thomas J. Felnagle
Hon. Thomas J. Felnagle

Approved as to Form:

Thomas D. Adams
L.T. Egan for NASD Inc
Carl Marquardt
John M. Keefe

IN THE SUPERIOR COURT,
PIERCE COUNTY, WASHINGTON

[Original handwritten]

Cacciola, et al.
Plaintiff.

vs.

Seabury & Smith, et. al.
Defendant.

MEMORANDUM OF JOURNAL ENTRY

No. 95-2-09591-2

ORDER

The above-captioned matter came before the Court on plaintiffs' motion to compel production of documents from defendants Seabury and Smith and National Union. Plaintiffs also requested the Court to consider an oral motion to continue the date of hearing on Defendants' Summary Judgment motions based on the assertion of Plaintiffs' counsel that their expert is unavailable and/or unwilling to participate.

Having heard the arguments of counsel, and having read the briefing submitted by the parties, it is hereby ORDERED:

(1) Plaintiffs' Motions to Compel are denied;

(2) The Court declines to hear Plaintiffs' oral Motion for Continuance of Summary Judgment Hearing because it has not been properly presented and noted. Even if such Motion was considered on it merits, the Court does not believe appropriate grounds

for a continuance have been suggested by counsel.

11-21-97

/s/ Thomas J. Felnagle
Judge.

Approved:

Thomas D. Adams
Attorney for Def National Union

Carl Marquardt
Attorney for Def Seabury & Smith
John M. Keefe WSBA 18371, Att'y for Plaintiffs

[/s/ TJF]

IN THE SUPERIOR COURT OF WASHINGTON
FOR PIERCE COUNTY

KOCHCAPITAL, INC., a Stock Brokerage Firm; THOMAS CACCIOLA and MARLENE CACCIOLA, Husband and Wife; PETER VETRANO and LEAN [sic] VETRANO, Husband and Wife; and WALLACE RUDOLPH and JANET RUDOLPH, Husband and Wife, Plaintiffs, v. SEABURY & SMITH, INC., a Delaware corporation; NATIONAL UNION FIRE INSURANCE CO. OF PITTSBURGH, PA, a Pennsylvania corporation; and JOHN DOES and JANE DOES 1-50, Defendants.	NO. 95-2-09591-2 ORDER GRANTING SEABURY & SMITH, INC.'S MOTION FOR SUMMARY JUDGMENT [PROPOSED] (Filed Dec. 5, 1997)

THIS MATTER came before the Court on defendant Seabury & Smith, Inc.'s ("Seabury & Smith") Motion for Summary Judgment seeking dismissal of all of the plaintiffs' claims. In addition to the presentation of argument in open court, the Court considered the following submissions:

1) Seabury & Smith's Motions for Summary Judgment and Award of Attorneys' Fees and Costs filed on March 15, 1996;

2) Declaration of Katherine D. Jacobson of January 1996;

3) Plaintiffs' Response to the Motion of Seabury & Smith, Inc. for Summary Judgment filed on April 2, 1996;

4) Defendants' Reply to Plaintiffs' Response to Seabury & Smith's Motion for Summary Judgment filed on April 8, 1996;

5) Supplemental Declaration of Katherine D. Jacobson of April 5, 1996;

6) Surreply [Plaintiffs'] on Motion for Summary Judgment and Declaration of John Keefe of April 11, 1996;

7) Verbatim Report of Proceedings of April 12, 1996, on Motion for Summary Judgment;

8) Seabury & Smith's Supplemental Memorandum in Support of Continued Motion for Summary Judgment filed on August 26, 1997;

9) Declaration of James D. Dawson of August 6, 1997;

10) Declaration of John D. Taylor of August 19, 1997;

11) Declaration of Joan C. Conley of April 25, 1997;

and the attachments and exhibits thereto and the other pleadings and records filed herein, NOW, THEREFORE,

THE COURT FINDS that: (1) No genuine issue of material fact exists in this matter; (2) Seabury & Smith is entitled to judgment as a matter of law;

IT IS HEREBY ORDERED that: (1) Seabury & Smith, Inc.'s motion for summary judgment is GRANTED; (2) All claims against Seabury & Smith are hereby DISMISSED with prejudice.

DONE IN OPEN COURT this 5th day of December, 1997.

/s/ Thomas J. Felnagle
Thomas J. Felnagle

(Filed Dec. 5, 1997)

Presented by:

STOKES LAWRENCE, P.S.

By /s/ Phillip H. Ginsberg
Phillip H. Ginsberg (#00164)
Scott A.W. Johnson (#15543)

Attorneys for Defendant Seabury & Smith, Inc.

Approved as to Form; Notice of Presentation Waived:

By _____
John M. Keefe (#18371)
Attorney for Plaintiffs

IN THE SUPERIOR COURT OF THE
STATE OF WASHINGTON
IN AND FOR THE COUNTY OF PIERCE

CACCIOLA, et. al., Plaintiffs, v. SEABURY & SMITH, INC., Defendants.	NO. 95209591-2 ORDER GRANTING DEFENDANT NATIONAL UNION'S MOTION FOR SUMMARY JUDGMENT (Filed Dec. 5, 1997)

The above-captioned matter came regularly before this Court on the motion of Defendant National Union Fire Ins. Co. of Pittsburgh, PA ("National Union"). Having heard the arguments of ~~counsel for Plaintiffs, John M. Keefe, and~~ [/s/ TJF] counsel for Defendant National Union, Thomas D. Adams, [and noting that counsel for plaintiffs have failed to appear,] and having reviewed the following pleadings:

1) Plaintiffs Second Amended Complaint

2) National Union's Answer and Affirmative Defenses

3) Seabury & Smith's Motion for Summary Judgment (March 15, 1996) [(and incorporated declarations /s/ TJF)]

4) Declaration of Kathryn Jacobson (3/16/95)

5) Second Declaration of Kathryn Jacobson (3/28/95)

6) Seabury & Smith's Supplemental Memorandum in Support of Continued Motion for Summary Judgment [(and incorporated declarations)]

7) Declaration of A. John Taylor

8) Declaration of James G. Dawson

9) National Union's Motion for Summary Judgment [(and incorporated pleadings and declarations)] [/s/ TJF]

10) Verbatim Report of Proceedings (4/12/96; Motion for Summary Judgment)

11) Plaintiff's Response To The Motion For Summary Judgment of Seaburg & Smith

12) Defendants' Reply to Plaintiffs' Response;

13) Surreply on Motion for Summary Judgment

this Court hereby finds there are no genuine issues of material fact and that National Union is entitled to judgment as a matter of law pursuant to CR 56 on all claims alleged by Plaintiffs. Accordingly, ***IT IS HEREBY ORDERED*** that National Union's motion is granted and all claims alleged against it are hereby dismissed with prejudice. National Union shall submit a proposed form of judgment forthwith.

Dated: December 5th, 1997.

/s/ Thomas J. Felnagle
Thomas J. Felnagle, Judge

Submitted by:

/s/ Thomas D. Adams
Thomas D. Adams, WSBA 18470
of attorneys for
Defendant National Union

Form Approved:

_____
John M. Keefe, WSBA 18371

IN THE SUPERIOR COURT OF THE
STATE OF WASHINGTON
IN AND FOR THE COUNTY OF PIERCE

KOCHCAPITAL, INC., et al. Plaintiffs, v. SEABURY & SMITH, INC., et al., Defendants.	)	NO. 95-2-09591-2 JUDGMENT (Proposed) *Clerk's Action Required*

JUDGMENT

(Filed Jan. 27, 1999)

1. Judgment Creditor : National Union Fire Insurance Co. of Pittsburgh, PA
2. Attorneys for Judgment Creditor : Thomas D. Adams
Bullivant Houser Bailey
Pendergrass & Hoffman
2400 Westlake Tower
1601 Fifth Ave.
Seattle, WA 98101-1618
Tel. (206) 292-8930
3. Judgment Debtors : Thomas Cacciola; Marlene Cacciola; Peter Vetrano; Lean Vetrano; Wallace Rudolph; Janet Rudolph; and John M. Keefe
5. Principal Amount of Judgment : $0

6.	Prejudgment Interest	: $0
7.	Post Judgment Interest	: To accrue at 12% per annum on costs and attorney fees Awarded herein until paid
8.	Attorney Fees	: $1,305.00 Pursuant to CR 11 and/or RCW 4.84.185
9.	Attorney Fees	: $500 Pursuant to *Order Denying Plaintiffs' Motion to Compel and Granting Terms to Defendants and to NASD, (dated 9/5/97)*
10	Costs	: $125

Pursuant to RCW 4.84.080(1)

Pursuant to this Court's *Order Granting Defendant National Union's Motion for Summary Judgment* entered on or about December 5, 1997, and pursuant to this Court's *Order Granting Defendant National Union's Motion for Entry of Judgment*, it is hereby

ORDERED and ADJUDGED that Defendant National Union's Motion for Entry of Judgment is granted and Judgment is hereby entered against Plaintiffs and Plaintiffs' counsel, jointly and severally for all sums itemized above, totalling $1,930.00., such Judgment to bear interest at the rate of 12% per annum until paid. All claims alleged by Plaintiffs against Defendant National Union are hereby dismissed with prejudice.

DATED this 27th day of January, 1998.

/s/ Thomas J. Felnagel
Thomas J. Felnagle, Judge

IN THE SUPERIOR COURT OF WASHINGTON
FOR PIERCE COUNTY

KOCHCAPITAL, INC., a Stock Brokerage Firm; THOMAS CACCIOLA and MARLENE CACCIOLA, Husband and Wife; PETER VETRANO and LEAN [sic] VETRANO, Husband and Wife; and WALLACE RUDOLPH and JANET RUDOLPH, Husband and Wife, Plaintiffs, v. SEABURY & SMITH, INC., a Delaware corporation; NATIONAL UNION FIRE INSURANCE CO. OF PITTSBURGH, PA, a Pennsylvania corporation; and JOHN DOES and JANE DOES 1-50, Defendants.	NO. 95-2-09591-2 JUDGMENT ~~[PROPOSED]~~ [/s/ TJF] **Clerk's Action Required**

JUDGMENT

(Filed Febr. 17, 1998)

1. Judgment Creditors: Seabury & Smith, Inc.
2. Judgment Debtor: Thomas Cacciola, Marlene Cacciola, Peter Vetrano, Lean Vetrano, Wallace Rudolph, Janet Rudolph, and John M. Keefe.

3. Principal Judgment Amount $ -0-
4. Interest to Date of Judgment: $ -0-
5. Attorney Fees (Reasonable): $ 3494
6. Attorney Fees (Statutory): $ 125
6. Costs: $ 231.34
7. Other Recovery Amount: $ -0-
8. Principal Judgment Amount shall bear interest at -0-% per annum.
9. Attorneys' Fees, Costs and Other Recovery Amounts shall bear interest at 12% per annum.
10. Attorneys for Judgment Creditor:

Phillip H. Ginsberg (#164)
Carl J. Marquardt (#23257)
Stokes Lawrence, P.S.
800 Fifth Avenue, Suite 4000
Seattle, WA 98104
(206) 626-6000

Pursuant to the Court's Order Granting Seabury & Smith's Motion for Summary Judgment, filed December 5, 1997, and the court's Order Granting Seabury & Smith's Motion for an Award of Attorney Fees and Costs, dated January 16, 1998, it is hereby

ORDERED that all claims against Seabury & Smith be dismissed with prejudice, and that judgment be entered against the plaintiffs and plaintiffs' counsel, jointly and severally, in the sum of $3725.34. Such judgment shall bear interest at the rate of 12% per annum from the date

hereof until paid. DATED this ~~17th~~ [/s/ TJF] day of February, 1998.

/s/ Thomas J. Felnagle
Judge Thomas J. Felnagle

Presented by:

STOKES LAWRENCE, P.S.

By /s/ Phillip H. Ginsberg
Phillip H. Ginsberg (#164)
Carl J. Marquardt (#23257)
Attorneys for Judgment Creditor

Approved as to Form: Notice of Presentation Waived:

John M. Keefe (#18371)
Attorney for Plaintiffs

APPENDIX D

Marsh & McLennan Group Associates
1255 23rd Street, N.W. Washington, D.C. 20037

March 27, 1989
Koch Capital, Inc. DBA
Kochcapital
ATTN: Jo Wolford
Bellevue, WA 98004

RE: NASD State Surety Bond Program
NASD ID #21038

Dear NASD Member:

Our records indicate that you have broker/dealer surety bonds in the following states with an anniversary date of April 1, 1989:

STATE	BOND AMOUNT	PREMIUM	CANCEL
AZ	25,000	$250.00	
HI	5,000	50.00	X
ID	25,000	250.00	
OR	10,000	100.00	

To continue coverage for the above states, please pay the premium shown above. Make your check payable to Marsh & McLennan Group Associates, and submit by April 30, 1989.

In the event you want to cancel coverage in one or more of the above states, please indicate by checking the cancel column and deducting the appropriate amount from your payment.

If you have any questions, call the Bond Unit at (202) 296-9640.

Sincerely,
Bond Unit

ps: Please note that these bonds are in addition to the fidelity bond required by the National Association of Securities Dealers.

Marsh & McLennan Group Associates
1255 23rd Street, N.W. Washington, D.C. 20037

May 10, 1989
Attn: Jo Wolford
Kochcapital
1300 114th Ave., S.E., Suite 232
Bellevue, WA 98004

NASD ID #: 21038

RE: NASD Surety Bond Renewal

We are in receipt of your recent Surety Bond payments for the renewal of your firm's state surety bonds.

Please be advised that we have renewed the state bonds checked below effective April 1, 1989.

	STATE		STATE	
AK		NM		
AZ	✓	OH		
AR		OK		
HI		OR	✓	
ID	✓	PA		
IN		SC		
LA		SC		(agent)
MI		UT		
NC		VA		
ND		VT		
NE		WV		
NH				

Should you have any further questions, please feel free to contact your underwriter at (202) 296-8030.

Thank you for you continued support of this program.

Sincerely,

/s/ Margaret McNeil
Underwriter
Bond Unit

SMITH-STERNAU
ORGANIZATION, INC.

A Marsh & McLennan Company

03/19/1990

KOCH CAPITAL, INC. DBA
KOCHCAPITAL [35 148th Ave SE]
ATTN: JO WOLFORD
BELLEVUE, WA 980070000
RE: SURETY BOND RENEWAL INVOICE – NASD ID# 21038

DEAR NASD MEMBER:

OUR RECORDS INDICATE THAT YOU HAVE BROKER/ DEALER SURETY BONDS IN THE FOLLOWING STATES WITH AN ANNIVERSARY DATE OF APRIL 1, 1990:

STATE	BOND AMOUNT	PREMIUM	CANCEL
AK	$5000	$50.00	( )
SC	$10000	$100.00	( )
AZ	$25000	$250.00	( )
ID	$25000	$250.00	( )
ND	$25000	$250.00	( )
OR	$10000	$100.00	( )

TO CONTINUE THE BONDS, PLEASE PAY THE PREMIUM SHOWN BY APRIL 15, 1990 AND RETURN A COPY OF THE INVOICE WITH YOUR CHECK. IF YOUR WANT TO CANCEL ANY OR ALL OF THE BONDS, PLEASE CHECK THE CANCEL COLUMN.

PLEASE NOTE THAT YOUR CHECK SHOULD BE MADE PAYABLE TO SMITH-STERNAU ORGANIZATION, INC. WHICH IS A MARSH & MCLENNAN COMPANY.

WE WOULD LIKE TO TAKE THIS OPPORTUNITY TO THANK YOU FOR YOUR BUSINESS AND SHOULD YOU HAVE ANY QUESTIONS CONCERNING YOUR BILLINGS, PLEASE CALL US AT (202) 296-9640.

SINCERELY,

BOND DEPARTMENT
1255 23rd STREET N.W.
WASHINGTON, DC 20037
202 296-9640

1255 23RD STREET
WASHINGTON, D.C. 20037

READ/REPLY
[ ] URGENT
[ ] SOON AS POSSIBLE
[ ] NO REPLY NECESSARY

To: Kochcapital
Attn: Jo Wolford
28815 Pacific Highway South
Suite 4
Federal Way, WA 98003

Date: October 21, 1988

Subject: Surety Bonds for Alaska & Hawaii NASD ID # 21038

MESSAGE

Dear Ms. Wolford:

Enclosed please find the surety bond for Alaska as requested. We are unable to complete the processing of your Hawaii bond since your remittance was short by $50.00 If you still want the Hawaii bond please submit the additional $50.00 to my attention. Thank you.

/s/ Margaret
Margaret McNeil
NASD Bond Department

STATE OF ARIZONA
ARIZONA CORPORATION COMMISSION
Securities Division
Dealer's Bond

Bond No. I ST-BOND #259-4395

KNOW ALL MEN BY THESE PRESENTS
Effective: August 1, 1988

That we, Kochcapital as principal, and THE AMERICAN INSURANCE COMPANY of 777 San Marin Drive, San Marin, California, a surety company authorized to transact business in the State of Arizona, are held and firmly bound unto the State of Arizona in the sum of TWENTY FIVE-THOUSAND DOLLARS AND NO/100 ($25,000.0) for the use and benefit of any person who shall have a cause of action against the above named principal, under Section 44-1943, Arizona Revised Statutes, for which payment well and truly to be made we bind ourselves, our heirs, executors, administrators, successors and assigns, jointly and severally, firmly be these presents.

THE CONDITION OF THE ABOVE OBLIGATION IS SUCH that:

WHEREAS, the above named principal is registered, or has made application for registration, with the Arizona Corporation Commission as a dealer in securities within the meaning of the Securities Act of Arizona, and is required by said Commission to furnish bond in the above named sum, conditioned as herein set forth:

NOW, THEREFORE, if the said principal obligor, his agents and employees shall faithfully comply with the provisions of the aforementioned Securities Act of Arizona, and shall promptly pay any judgment recovered

State of Hawaii
DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS
Business Registration Division
1010 Richards Street
Mailing Address: P.O. Box 40, Honolulu, Hawaii 96810

1st Bond # 259-4395 Effective Date: October 3, 1988

BOND FOR DEALER IN, ISSUER OF OR INVESTMENT ADVISER IN SECURITIES

KNOW ALL MEN BY THESE PRESENTS:

That we, Kochcapital (*name of applicant company*) of 28815 Pacific Highway South, 4 Federal Way, WA 98003 (*applicant's complete principal/business address*) as principal, and The American Insurance Company (*name of surety company*), of 777 San Marin Dr., San Marin, California (*surety's complete principal business address*), as surety, are held and firmly bound unto the State of Hawaii in the sum of FIVE THOUSAND DOLLARS ($5,000.00), in legal money of the United States of America, for the payment of which to said State of Hawaii well and truly to be made, we do hereby bind ourselves and our respective heirs, executors, administrators, successors and assigns, jointly and severally, firmly by these presents.

Witness our hands and seals at _____ (*city and state of principal's execution*) by said _____ (*name of applicant company*) this _____ day of, 19___, (*principal's execution date*) and at Washington, D.C. (*city and state of surety's execution*)

By said The American Insurance Company (*name of surety company*) this _____ day of _____, 19 ____. (*surety's execution date*).

* * *

STATE OF IDAHO
DEPARTMENT OF FINANCE
Securities Bureau
1st Bond# 259-4395-320

INDEMNITY BOND FOR BROKER/DEALER

STATE OF IDAHO)
) ss.
COUNTY OF ___)

Effective Date: August 1, 1988

KNOW ALL MEN BY THESE PRESENTS, that Kochcapital (Broker/Dealer) of the County of King, State of Washington as PRINCIPAL and The American Insurance Company, State of New Jersey, a surety corporation duly qualified to do business in the State of Idaho as surety, is held and firmly bound unto the State of Idaho, and/or any person, firm or corporation interested, in the sum of TWENTY-FIVE THOUSAND DOLLARS lawful money of the United States of America for the payment whereof well and truly to be made, we do bind ourselves, our and each of our heirs, assigns, executors and administrators, jointly and severally, firmly by these presents.

The condition of this obligation is such, that whereas, the Idaho Department of Finance, under the provisions of the Idaho Securities Act has registered the said PRINCIPAL herein named as a Broker/Dealer to sell securities in the state of Idaho.

AND WHEREAS, the said Broker/Dealer is authorized by said Act to appoint Agents and represent and assist said Broker/Dealer in the sale of said securities.

NOW THEREFORE, if the above bounded PRINCIPAL herein named, shall truly report to the Idaho Department of Finance the names and addresses of all agents so appointed and employed in the sale of said securities, and said PRINCIPAL herein named as such Broker/Dealer, and each and every Agent registered by said Broker/Dealer shall well and truly comply with the provisions of the Idaho Securities Act, and then this obligation to be void, otherwise to remain in full force and effect.

PROVIDED, HOWEVER, AND UPON THE FOLLOWING EXPRESS CONDITIONS:

That every person having a cause of action under the Idaho Securities Act, may initiate suit in any court of competent jurisdiction against the principal and/or the surety upon this bond. No suit may be maintained to enforce any liability on the bond unless brought within three years after the sale or other act upon which it is based.

PROVIDED, always, that nothing herein shall be construed to make the total maximum liability hereunder of the above named principal and/or surety more than TWENTY-FIVE THOUSAND DOLLARS regardless of the number of acts of omission or commission of the above named principal and/or its agents.

PROVIDED, FURTHER, that before any person, firm or corporation shall have any right of action, or any right whatsoever, against the principal and/or the surety upon this bond, and before any such right of action, or any such right whatsoever shall exist or arise, such person,

firm or corporation, within the period of three years after the termination of this bond, must have given to the surety and the principal written notice.

* * *

SEABURY & SMITH Insurance Program Management

November 5, 1990
Koch Capital, Inc. DBA
Attn: Jo Wolford
35 148th Avenue, S. E.
Bellevue, WA 98007

RE: SURETY BOND RENEWAL INVOICE - NASD ID# 21038 FOR ALABAMA, IOWA AND/OR UTAH WITH AN ANNIVERSARY DATE OF DECEMBER 31.

Dear NASD Member:

Our records indicate that your firm has a surety bond in the following state(s):

STATE	BOND AMOUNT	PREMIUM	CANCEL
IA	$15,000	$150.00	( )

(Note: This billing is in addition to the NASD Fidelity invoice you may have received in early September.)

Because you must send evidence of coverage continuation to the State, we will need the premium as early as possible and no later than November 20, 1990. Please return a copy of this invoice with your check made payable to Seabury & Smith.

If you want to cancel coverage, check the cancel column and return to our office.

When processing has been completed, the bond will be sent to you for filing with the State(s).

Thank you for the opportunity to serve your bonding needs. Should you have any questions, please call us at 202/296-9640.

Sincerely,

A Marsh & McLennan Company

Bond Department

ND
Securities Commissioner
State Capital
BISMARCK, ND 58505
(701) 224-2910

Dealer Indemnity Bond

Form S-7
REV. 5-83

Effective Date: February 1, 19[illegible]

KNOW ALL MEN BY THESE PRESENTS: BOND NO. 259-4395

That Kochcapital, Inc. of the City of Bellevue, State of Washington, as Principal, and The American Insurance Company, a corporation organized and existing under the laws of the State of New Jersey and authorized to do business in the State of North Dakota, as Surety, are by this obligation held and firmly bound unto the State of North Dakota for the use, benefit, and protection of any person (as that term is defined in the Securities Act of 1951, as amended) in the penal sum of **Twenty-Five Thousand Dollars* ($25,000.00), lawful money of the United States of America, for the payment of which sum, well and truly to be made, we bind ourselves, our heirs, executors, administrators, successors and assigns, jointly and severally, firmly by these presents.

The conditions of this obligation are such that, whereas, the said Principal has applied or intends to apply for registration pursuant to the Securities Act of 1951, as amended:

NOW, THEREFORE, THIS INDENTURE WITNESSETH, that if the said Principal, his agents, and his salesmen shall faithfully comply with all of the provisions of the Securities Act of 1951, as amended, and with all rules, regulations, and orders made pursuant thereto

and shall faithfully perform and pay all obligations of the said Principal, his agents, and his salesmen, then this obligation to be void, otherwise to remain in full force and effect.

This bond is a continuing obligation and shall cover the full period or periods of registration of the Principal under the Securities Act of 1951, as amended, including the present and all renewal registrations which said Principal may be granted; provided, that it is hereby expressly agreed that nothing herein contained shall be deemed or construed to reduce the liability of the Principal and Surety below the penal sum set forth above for each and every registration period for which the named Principal shall be registered, the same as if a new bond in the said penal sum were entered into for each and every separate registration period.

This bond may be cancelled at any time by the Surety by giving written notice of such cancellation by registered mail to the Securities Commissioner and to the Principal, and liability hereunder shall terminate thirty (30) days after receipt by the Securities Commissioner of such notice, except that the liability of the Principal and Surety shall apply as provided herein to any acts or omissions which may have occurred prior to the effective date of such cancellation.

IN WITNESS WHEREOF, the Principal and Surety have hereunto set their hands and affixed their respective seals this 22nd day of February, 1990.

Kochcapital, Inc.
(Principal)

(Seal)

(Name and Title)

The American Insurance Company
(Surety)

(Seal)

(Attorney-in-Fact)

Washington, DC,
(Address of Attorney-in-Fact)

Countersignature /s/ F.R. Montgomery

Attorney-in-Fact must attach valid Power of Attorney from Surety. If Principal is a corporation, officer signing must attach resolution authorizing execution.

STATE OF OREGON
DEPARTMENT OF INSURANCE AND
FINANCE DIVISION OF FINANCE
AND CORPORATE SECURITIES
SECURITIES SECTION
21 Labor and Industries Building,
Salem, Oregon 97310-0768
(503) 378-4387

Bond No.: 259-4395
Effective Date: August 1, 1988

SURETY BOND
(ORS 59.175(4))

Kochcapital (Principal) has applied to the State of Oregon, Department of Insurance and Finance, Division of Finance and Corporate Securities, Securities Section for a license as a broker-dealer, mortgage broker, or investment adviser under ORS Chapter 59 and is required by ORS 59.175 to furnish a bond in the sum of TEN THOUSAND U.S. DOLLARS ($10,000).

The American Insurance Company (Surety) is a corporation authorized by the Insurance Commissioner to transact insurance in the State of Oregon and is obligated to pay to the State of Oregon for the use and benefit of any interested person, the sum of $10,000.

If the Principal and its agents and employees comply with the provisions of the Oregon Securities Law, now or therefore enacted, this obligation shall be void. If the Principal or its agents or employees violate any provisions of the Oregon Securities Laws and fail to pay all damages suffered by any person due to violation of the Oregon Securities Law, the Surety is obligated to pay any damages suffered as a result of the violations up to $10,000.

This bond becomes effective on August 1, 1988 and shall remain in force until the Department of Insurance and Finance, Division of Finance and Corporate Securities, Securities Section releases the Surety from liability, or until the Surety cancels this bond. The Surety may cancel this bond and be relieved of further liability hereunder by giving 30 days' written notice to the Principal and to the Department of Insurance and Finance, Division of Finance and Corporate Securities, Securities Section.

This bond shall be one continuing obligation, and the liability of the Surety for the aggregate of any and all claims which may arise shall not exceed $10,000.

This Surety and its heirs, personal representatives, successors, and assigns, and the Principal and its heirs, personal representatives, successors, and assigns by this agreement bind themselves, jointly and severally, to the State of Oregon.

PRINCIPAL: Kochcapital
Address: 28815 Pacific Highway Suite, Suite #4 Federal Way (city), Washington (State) 98003 (Zip)
By: /s/ Russell Koch (Typed Name)
Signature: /s/ Russell Koch
Date: 8/25/88
SURETY: The American Insurance Company
Address: 777 San Marin Drive
San Marin (City), CA (State) (Zip)
By: /s/ Kirk Gaskins (Attorney in Fact/Registered Agent (Typed Name)
Signature: /s/ Kirk Gaskins
Date: August 5, 1988

BROKER – DEALER AND INVESTMENT ADVISOR SURETY BOND
STATE OF SOUTH CAROLINA
SOUTH CAROLINA SECURITIES COMMISSIONER
501 Edgar Brown Bldg.
1205 Pendleton Street
Columbia, S.C. 29201

Bond No. 259-4395

KNOW ALL PERSONS BY THESE PRESENTS:

That, Koch Capital, Inc., DBA Kochcapital (Name and address of broker-dealer or), 114th Avenue, SE, Suite 232, Bellevue, WA 98009 Principal, having filed with the office of the South Carolina Securities Commissioner on or about the 1st day of November, 1989, an application to transact business in this State as a BROKER/DEALER (Designate whether principal is B/D or I/A and The American Insurance Company, 777 San Marin Drive San Marin, CA (Name and adress of surety) as Surety a corporation organized under the laws of the State/Commonwealth/Territory of New Jersey and being duly authorized to transact the business of indemnity and suretyship in this State, do hereby acknowledge our indebtedness to the State of South Carolina, for the use and benefit of any person(s) having a claim under the conditions of this obligation, in the sum of Ten Thousand Dollars ($10,000.00), as required by Section 35-1-510, provided, however, that the aggregate liability hereunder shall not exceed the sum of Ten Thousand Dollars, ($10,000) regardless of the number of claimants, and shall not be construed as individual liability.

LIABILITY for the payment of this sum, to which we hereby obligate and bind ourselves, our heirs, executors, administrators, successors and assigns, jointly and severally, becomes effective upon the following conditions:

1. Registration/Licensing of the Principal to transact business in this State as a Broker/Dealer (Designate whether principal is a broker-dealer or investment advisor)

and

2. Failure by the Principal to strictly comply with all applicable provisions of, and orders, rules and regulations issued pursuant to, the applicable securities statutes of the particular state, commonwealth or territory in which such Principle is registered.

THIS Bond shall expire at such time as the Principal's registration is withdrawn, terminates through non-renewal or is revoked by the South Carolina Securities Commissioner except as to liability for acts or omissions which occur prior to such time. This Bond may also be cancelled by the Surety upon 30 days written notice by registered mail to the Principal and to the South Carolina Securities Commissioner.

In which case this Bond shall be cancelled upon the expiration of said 30 days period except as to liability for acts or omissions which occur prior to the date of cancellation. Notice shall be deemed effective upon receipt by the applicable state agency of said written notice along with sufficient proof of notice to the Principal.

NO suit may be maintained to enforce any liability arising under this Bond unless brought within three years after discovery of the act or omission upon which liability is based.

IT is understood and agreed that any person(s) having a claim under the conditions of this obligation may initiate suit in any court of competent jurisdiction against the Principal and/or the Surety upon this Bond.

WITNESS OUR SIGNATURES, this the _____ day of _____, 19_____.

Koch Capital, Inc., DBA Kochcapital
Principal

_____

By

(corporate seal, if applicable)

_____

APPENDIX E

THE HONORABLE SHARON S. ARMSTRONG

IN THE SUPERIOR COURT OF WASHINGTON
FOR KING COUNTY

THOMAS CACCIOLA, et al., Plaintiffs, v. KOCHCAPITAL, INC., et al., Defendants.	)))))))	No. 92-2-17010-8 DECLARATION OF KATHRYN D. JACOBSON

KATHRYN D. JACOBSON declares and states as follows:

IDENTITY AND QUALIFICATIONS

1. I am Vice President of Property Casualty for Seabury & Smith and the manager of the bond department. I have worked in Seabury & Smith's bond department since June 1992. Seabury & Smith is the insurance program management arm of the Marsh & McLennan Group of Companies. I am familiar with the NASD Group Fidelity Bond Buying Program. I also have reviewed and am familiar with the Seabury & Smith file for Kochcapital. This declaration is based on my review of the Kochcapital file.

NASD BOND PROGRAM

2. The National Association of Securities Dealers ("NASD") sponsors the NASD Group Fidelity Bond Buying Program, to provide fidelity bonds to NASD member

securities broker dealers. NASD members meeting program criteria can purchase fidelity bond coverage that complies with the NASD's requirements for the fidelity bonds. Seabury & Smith is the program administrator. National Union Fire Insurance company ("National Union") is the underwriter. The underwriter is the insurance company on whose paper the bond is issued. Although it has been alleged in this action, Seabury & Smith is not, and has never been, an underwriter of securities dealer fidelity bonds.

3. As the program administrator, Seabury & Smith serves as a centralized billing and collection unit on behalf of the underwriter, National Union. Seabury & Smith's role is limited to (a) receiving and processing applications from NASD member broker dealers, (b) collecting and transmitting to National Union the requisite premiums, (c) sending the NASD members the complete bond and annual renewal declaration pages and amendment endorsements, and (d) aiding in preparing and presenting of claims on behalf of members who request such assistance.

4. It has been alleged in this action that Seabury & Smith failed to provide notice to National Union of a loss suffered by Kochcapital. Seabury & Smith has no authority to handle or settle claims. Upon written notification of a potential loss from a NASD member client, Seabury & Smith would promptly forward the request to National Union by overnight mail. If a NASD member client telephoned to report a potential loss, Seabury & Smith would advise the client to submit it in writing to National Union. Upon National Union's request, Seabury & Smith

would provide copies of the client file, applications and other relevant documents. If anyone other than the NASD member client called to present a claim on a bond, Seabury & Smith would advise them it is a first-party coverage bond only, and would not accept notice from anyone other than the NASD member. Seabury & Smith has never undertaken any obligation to provide the required written notice of a loss to National Union for or on behalf of any securities dealer.

KOCHCAPITAL'S BOND COVERAGE

5. Kochcapital was a securities broker dealer and a member of the NASD, No. 21038. Originally issued in the name of Ariel Investments, Inc., the name on the bond was changed to Kochcapital effective May 9, 1988. Kochcapital was covered under the securities dealer blanket bond purchased through the NASD Group Fidelity Bond Buying Program from May 9, 1988, until November 1, 1990.

6. Attached as Exhibit A is a true and correct copy of the securities dealer blanket bond under which Kochcapital was insured. The bond insures against a variety of losses that may be sustained by the insured at any time, but "discovered" during the bond period. Section 4 of the bond provides that any legal proceedings to recover a loss shall not be brought after the expiration of 24 months from the discovery of such loss. Attached as Exhibit B is a true and correct copy of each of the securities dealer blanket bond declarations national Union issued to Kochcapital.

7. On November 16, 1990, Seabury & Smith as attorney-in-fact for National Union under the NASD bond program notified Kochcapital that the bond was canceled effective November 1, 1990, due to non payment of premium. Attached as Exhibit C is a true and correct copy of the cancellation notice sent to Kochcapital.

8. On December 15, 1990, Michael Borth, operations manager for Kochcapital, applied to reinstate the fidelity bond. By submitting a renewal application and self rating form together with a premium check, Mr. Borth attested

that no claims had been made against the bond in the prior three years. Attached as Exhibit D is a true and correct copy of the renewal application and self rating form Mr. Borth signed and submitted to Seabury & Smith, as well as the other applications Kochcapital submitted.

9. In connection with that application, Seabury & Smith required a no loss warranty letter signed on Kochcapital's letterhead by a person with authority warranting that the company has no known or potential losses during the period from the time the bond expired until it is reinstated. Mr. Borth submitted such a letter certifying that Kochcapital

knew of no loss or potential loss under the bond. Attaches as Exhibit E is a true and correct copy of Mr. Borth's no loss warranty letter.

10. Mr. Borth's signature on the renewal application and the no loss warranty letter certified that as of December 15, 1990, Kochcapital had not "discovered" a loss covered under the bond.

11. The application for renewal of the fidelity bond Seabury & Smith received from Mr. Borth was not filled out correctly. Consistent with our procedures, Seabury & Smith returned it and the premium check to Mr. Borth with a new blank application. Attached as Exhibit F is a true and correct copy of the letter returning the renewal application and premium check to Mr. Borth. Seabury & Smith requested that Mr. Borth correctly complete the new application and return it with the appropriate premium. Seabury & Smith also requested that he submit a new no loss warranty letter.

12. Seabury & Smith never received a new application or premium check from Kochcapital after that. Accordingly, the bond was never reinstated.

NO EVIDENCE OF ANY LOSS DISCOVERED BY KOCHCAPITAL

13. In my review of Seabury & Smith's file for Kochcapital, I could find no evidence that Seabury & Smith ever received any written notice of a loss discovered prior to November 1, 1990. I also could find no evidence that Seabury & Smith ever received any oral notice from any one at Kochcapital indicating that it had discovered a loss or potential loss to be made against the bond.

14. It is the custom and practice of Seabury & Smith to record in the client's file any written or oral notice of a potential loss covered under the bond. If Kochcapital had provided written notice of a loss to Seabury & Smith, rather than to National Union as required under the terms of the bond, Seabury & Smith would have sent a copy of the written notice directly to National Union's claims department, in accordance with Seabury & Smith's standard practices. If Kochcapital had ever telephoned Seabury & Smith to provide oral notice of a loss under the terms of the bond, Seabury & Smith would have documented the telephone call for

its file and would have advised National Union of the call, in accordance with Seabury & Smith's standard practices. No such document exists in Seabury & Smith's file for Kochcapital.

15. Aside from this lawsuit, no evidence exists that any one has brought any legal proceedings on the Kochcapital bond other than this one.

I declare under the penalty of perjury under the laws of the United States of America and the State of Washington that the foregoing is true and correct.

Executed at Washington, D.C., March 16, 1995.

/s/ Kathryn D. Jacobson
Kathryn D. Jacobson

IN THE SUPERIOR COURT OF WASHINGTON
FOR PIERCE COUNTY

KOCHCAPITAL, INC., et al., Plaintiffs, v. SEABURY & SMITH, INC., et al., Defendants.	NO. 95-2-09501-2 DECLARATION OF KATHRYN D. JACOBSON

I, Kathryn D. Jacobson, am over the age of 18, have personal knowledge of all the facts stated herein, and declare as follows:

1. I am Vice President of Property Casualty for Seabury & Smith and the manager of the bond department. I have worked for Seabury & Smith's bond department since June 1992. Seabury & Smith is the insurance program management arm of the Marsh & McLennan Group of Companies. I am familiar with the State Surety Bond Program administered by Seabury & Smith.

2. During the time that Kochcapital was an NASD broker dealer, Seabury & Smith administered a State Surety Bond Program through which securities brokers dealers could obtain surety bond coverage as required by various states. Until approximately April 1993, the American Insurance Company was the underwriter of all surety bonds purchased through the State Surety Bond Program administered by Seabury & Smith. Seabury & Smith is not and has never been and underwriter of state surety bonds for securities brokers dealers.

3. The State Surety Bond Program administered by Seabury & Smith is not the only provider of state surety bonds for NASD broker dealers. Many other insurance and bond companies have provided surety bonds for securities dealers.

I declare under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

EXECUTED at Washington, D.C. this 30 day of November, 1995.

/s/ Kathryn D. Jacobson
Kathryn D. Jacobson

IN THE SUPERIOR COURT OF WASHINGTON
FOR PIERCE COUNTY

KOCHCAPITAL, INC., a Stock Brokerage Firm; THOMAS CACCIOLA and MARLENE CACCIOLA, Husband and Wife; PETER VETRANO and LEAN VETRANO, Husband and Wife; and WALLACE RUDOLPH and JANET RUDOLPH, Husband and Wife, Plaintiffs, v. SEABURY & SMITH, INC., a Delaware corporation; NATIONAL UNION FIRE INSURANCE CO. OF PITTSBURGH, PA, a Pennsylvania corporation; and JOHN DOES and JANE DOES 1-50, Defendants.	NO. 95-2-09591-2 DECLARATION OF KATHRYN D. JACOBSON

KATHRYN D. JACOBSON declares and states as follows:

1. I am Vice President of Property Casualty for Seabury & Smith and the manager of the bond department. I have worked for Seabury & Smith's bond department since June, 1992. Seabury & Smith is the insurance program management arm of the Marsh & McLennan Group of Companies. I am familiar with the securities dealers blanket bond program administered by Seabury & Smith.

2. A securities dealers blanket bond provides first person loss coverage for employee dishonesty ("fidelity"); robbery, burglary and theft ("on premises" and "in transit"); forgery ("forgery or alteration"); and counterfeit or forged securities or currency ("securities" and "counterfeit currency"). Although the securities dealers blanket bond provides coverage for several different types of losses, it is commonly referred to as a "fidelity" bond. As used in the bond, the "Underwriter" is like the insurer or an insurance contract and is obligated to

indemnify and hold harmless the insured, in this case Kochcapital, for any covered loss up to the limits of the policy.

3. I know of no policy, rule or regulation issued by NASD or any other authority that would require Seabury & Smith to monitor or enforce Kochcapital's compliance with the fidelity bond rule, net capital rule or any other NASD regulation or rule.

4. Seabury & Smith is not a member of the NASD. Marsh & McLennan Securities Corporation, a separate corporation that is a wholly owned subsidiary of Seabury & Smith, is a member of the NASD. The NASD regulations do not apply to Seabury & Smith. The NASD regulators do not impose any duty on Seabury & Smith to ensure that NASD members are bonded.

5. In my review of Seabury & Smith's file on Kochcapital, I could find no evidence that Seabury & Smith knew that Kochcapital was operating without a bond and effecting securities and case transactions for public customers in violation of NASD rules prior to the first lawsuit that plaintiffs brought against Seabury & Smith in King County, Washington. Seabury & Smith did not know whether or not Kochcapital obtained fidelity bond coverage through other programs or whether or not Kochcapital even continued to operate as a securities dealer.

6. The NASD rules clearly and unequivocally place the burden of compliance on the member broker-dealer, not on Seabury & Smith. While the NASD bonding rule and net capital rule may require a member broker-dealer

to be bonded at a certain amount, that obligation to purchase and maintain the proper bond coverage rests with the NASD member. In fact, the NASD Fidelity Bond Buying Program administered by Seabury & Smith relies on self-rating applications. Michael Borth, operations manager for Kochcapital, completed the renewal self-rating applications and affirmed all the information to be true and complete. Mr. Borth determined the minimum net capital amount for Kochcapital. Kochcapital, not Seabury & Smith, determined the amount of bond coverage required under the NASD rules.

7. Seabury & Smith is not and has never been an underwriter of securities dealers blanket bonds.

8. Seabury & Smith is not and has never been an underwriter of state surety bonds.

9. No written agreement exists between Seabury & Smith and Kochcapital.

10. No agreement exists between Seabury & Smith and the other plaintiffs.

11. A certified copy of my First Declaration filed in support of Seabury & Smith's motion for summary judgment in the prior King County action is herein incorporated by this reference and attached as Attachment ~~2~~ 1. Together with corresponding exhibits A through F (hereinafter "First Jacobson Dec.")[1]

12. A copy of my Second Declaration filed in support of Seabury & Smith's motion for summary judgment in the King County action is herein incorporated by this reference and attached as Attachment ~~3~~ 2 hereinafter "Second Jacobson Dec.").

I declare under penalty of perjury under the laws of the United States of America and of the District of Columbia that the foregoing is true and correct.

EXECUTED at Washington, D.C., January, 1996.

/s/ Kathryn D. Jacobson
Kathryn D. Jacobson

[1] For ease of reference, this declaration submitted in support of motion for summary judgment in the present case will be referred to as "Jacobson Dec."

IN THE SUPERIOR COURT OF WASHINGTON
FOR PIERCE COUNTY

KOCHCAPITAL, INC., A Stock Brokerage Firm; THOMAS CACCIOLA and MARLENE CACCIOLA, Husband and Wife; PETER VETRANO and LEAN VETRANO, Husband and Wife; and WALLACE RUDOLPH and JANET RUDOLPH, Husband and Wife, Plaintiffs, v. SEABURY & SMITH, INC., a Delaware corporation; NATIONAL UNION FIRE INSURANCE CO. OF PITTSBURGH, PA a Pennsylvania corporation; and JOHN DOES and JANE DOES 1-50, Defendants.	NO. 95-2-09591-2 SUPPLEMENTAL DECLARATION OF KATHRYN D. JACOBSON

KATHRYN D. JACOBSON declares and states as follows:

1. I submit this declaration in response to certain factual assertions made in plaintiffs' opposition to Seabury & Smith's motion for summary judgment.

2. Plaintiffs repeatedly assert that Seabury & Smith has not provided any copies of what they refer to as "the underwriting agreements" between Seabury & Smith and

National Union for the NASD Group Fidelity Bond Buying Program. In fact, no such agreement exists. To my knowledge, there has never been any written agreements between National Union and Seabury & Smith regarding the NASD fidelity bond program. While Seabury & Smith was the broker of the fidelity bond for Kochcapital and served as an agent for National Union, I know of no written agency agreement between National Union and Seabury & Smith. Although Anthony Lynch, the prior manager of the bond department at Seabury & Smith, acted as attorney in fact for National Union for purposes of the NASD fidelity bond program, I know of

no written power of attorney signed by National Union. While plaintiffs speculate that some written agreement exists between Seabury & Smith and National Union, I know of no such agreement.

3. Plaintiffs also assert, without any factual support, that the NASD Group Fidelity Bond Buying Program is the only source from which small or medium sized securities brokerage firms could obtain fidelity bond coverage that complies with Section 32 of the NASD's Rules of Fair Practice. That is not true. While the majority of NASD members purchase their fidelity bond coverage through the NASD Group Fidelity Bond Buying Program administered by Seabury & Smith and underwritten by National Union, I know of at least six other companies that provide fidelity bond coverage that complies with Section 32 of the Rules of Fair Practice. The Surety Association, the regulatory association for bonding companies that establishes standard forms of coverage, has adopted what was called Form 14 Stock Brokers Blanket Bond, and is now called Financial Institutions Form 14. Form 14 provides all of the coverage required under NASD Section 32. Among the insurance and bonding companies that provide coverage under Form 14 are Aetna, USF&G, The Hartford, Continental Fidelity & Deposit of Maryland (the large bonding company in the United States) and St. Paul Fire & Marine Insurance Co. Each of these companies has provided and provides fidelity coverage for NASD member securities broker-dealers. In fact, competition in the market of fidelity bond coverage for NASD member securities broker-dealers is fierce, and the number of NASD members who purchase their fidelity

bond coverage through the NASD Group Fidelity Bond Buying Program has declined over the last few years.

4. Plaintiffs also assert that Seabury & Smith administers the NASD Group Fidelity Bond Buying Program under a "contract" with the NASD. That is absolutely false. There is no contract between the NASD and Seabury & Smith regarding the fidelity bond program.

5. The NASD Group Fidelity Bond Buying Program relies on self rating applications and a group rating process. This simplified underwriting approach is intended to maintain reasonable premiums for the coverage. It is solely the obligation of the NASD member applying for fidelity bond coverage to properly complete the Renewal Application/Self Rating Form. As

long as the NASD member meets the eligibility for the self-rating plan, Seabury & Smith does not investigate the member or require the member to submit audited financial information to verify its minimum net capital requirements. Only when a member does not meet the criteria does Seabury & Smith require individual underwriting information. In that case, employees of the bond department will individually underwrite the coverage (ie. determine whether the risk is insurable, any conditions of such coverage, and the appropriate premium).

6. Plaintiffs continue to confuse the concept of an individual's title as "underwriter" with the concept of the "Underwriter" of the bond. The fact that Kevin Adamson, Sally Love or other employees of the Seabury & Smith bond department have the title "underwriter" does not mean that Seabury & Smith is the Underwriter or "joint underwriter" of Kochcapital's securities dealer blanket bond. The underwriter of Kochcapital's bond is National Union. It is the company providing the bond coverage. It is the insurer responsible for indemnifying and defending Kochcapital for any covered loss. Mr. Adamson and Mrs. Love use the title "Underwriter" because they provide underwriting services for the bond department. In those instances in which an NASD member does not meet the eligibility criteria for the self-rating plan and submit additional underwriting information, Mr. Adamson, Ms. Love or other employees of the bond department would review the information, determine whether to provide fidelity bond coverage, what if any conditions would be required for coverage and the amount of the premium. They would also place the coverage with National Union, or another bonding company as appropriate.

7. Plaintiffs indicate in their opposition that Seabury & Smith does not deny that it knew about the NASD's administrative actions against Kochcapital in September 1990 and January 1991. From my review of Kochcapital's bond file, I can find no evidence that Seabury & Smith was ever advised by either the NASD or Kochcapital that such actions had been taken. In fact, there is no indication in either the Renewal Application/ Self Rating Form or the no loss warranty letter that Mr. Borth submitted in December 1990 that such actions had been taken by the NASD. The Renewal Application/Self Rating Form, signed by Mr. Borth as Kochcapital's operations manager, states that "EVERY APPLICANT OR INSURED, WHEN SEEKING A

QUOTATION, OR TAKING OUT OR RENEWING AN INSURANCE POLICY IS REQUIRED TO ADVISE THE PROSPECTIVE INSURER OF ANY MATERIAL FACT OR INFORMATION WHICH MIGHT AFFECT THE JUDGMENT OF THE INSURER IN DECIDING WHETHER TO ACCEPT THE INSURANCE OR ASSESSING THE CONDITIONS OF THAT INSURANCE. FAILURE TO OBSERVE THIS OBLIGATION COULD VOID ANY CONTRACT ENTERED INTO AT INCEPTION." There is nothing in Kochcapital's file to indicate that Mr. Borth or anyone else at Kochcapital gave Seabury & Smith notice of the NASD's action against the firm. Had Seabury & Smith known of such action, it very likely would not have accepted Kochcapital's application for coverage and would not have provided any fidelity bond coverage. As it turned out, Mr. Borth did not properly complete the application and it and Kochcapital's check were returned to him together with a new blank application. Mr. Borth never resubmitted a renewal application and Kochcapital's bond was never reinstated.

I declare under penalty of perjury under the laws of the United States of America and of the District of Columbia that the foregoing is true and correct.

EXECUTED at Washington, D.C., April ___, 1996.

/s/ Kathryn D. Jacobson
Kathryn D. Jacobson

APPENDIX F

IN THE SUPERIOR COURT OF THE
STATE OF WASHINGTON

IN AND FOR THE COUNTY OF PIERCE

KOCHCAPITAL, INC., a Stock Brokerage Firm; THOMAS CACCIOLA and MARLENE CACCIOLA, husband and wife; PETER VETRANO and LEAN VETRANO, husband and wife; and WALLACE RUDOLPH and JANET RUDOLPH, husband and wife, Plaintiffs, vs. SEABURY & SMITH, INC., a Delaware Corporation; NATIONAL UNION FIRE INSURANCE CO. OF PITTSBURGH, PA, a Pennsylvania Corporation; and JOHN DOES and JANE DOES 1-50 Defendants.	NO. 95-2-09591-2 MOTION FOR SUMMARY JUDGMENT

VERBATIM REPORT OF PROCEEDINGS

BE IT REMEMBERED that on the 12th day of April, 1996, the above-entitled and numbered cause came on for hearing before the Honorable Thomas J. Felnagle, one of the judges of the above-named courts, sitting in Department No. 15 thereof, in the County-City Building, in the City of Tacoma, County of Pierce, State of Washington;

The plaintiff, Cacciola and Vetrano, appeared through their attorney, John M. Keefe;

The plaintiff, Rudolph, appeared pro se;

The defendant, Seabury & Smith, appeared through its attorney, Scott A. W. Johnson;

The defendant, National Union Fire Insurance Company, appeared through its attorney, Thomas D. Adams;

The following proceedings were had, to wit:

Reported by: JAN-MARIE GLAZE, CSR
CSR# GLAZEJ*3370R

[34] is $25,000 for a broker/dealer; that's the minimum that a broker/dealer must maintain. Assuming the broker/dealer. has that, 120 percent of $25,000 is $30,000.

Now, the net capital reports from Christopfel Stabler shows net capitals exceeding net capitals $100,000 for both 1989 and 1990, and the rule says that the bond must be set at 120 percent of the broker/dealer's net capital, highest net capital, during the 12-month period.

If I could just add one more thing? That would be that I didn't mean for our submissions to be so voluminous, but things have been said, and I'll just characterize it as this: That are unfair, and so I've had to clutter this record to show that there's a basis for what we're doing in the King County action, as well, in my opinion, that's not relevant to this case. These are different claims. Okay?

THE COURT: All right. I have some concerns, and let me list them for you. I have two primary factual

concerns, two lesser factual concerns, and one big legal concern.

My first factual concern is that I'm unclear about the working relationship between Seabury & Smith and the NASD. And my second big factual concern is that I'm unclear about the role of the NASD as an enforcement [35] agency, and then, obviously, unclear about its administrative arms role as an enforcement agency. And until I have a better factual handle on those two things, I can't determine if there's a duty and to what extent that duty is.

Now, legally, I know there are cases, and I saw them cited in Mr. Keefe's brief to the Court of Appeals, that suggested stock exchanges can be liable to the investing public, but I don't know how that relates to this particular case with any specificity, and I, of course, have no idea how it might relate to somebody in the position of Seabury & Smith. So that's a legal concern that I have yet to reconcile.

The two lesser factual concerns I have because they don't go to the very heart of this motion for summary judgment, but are obviously central to the lawsuit, are what bonding alternatives were available, and what amount of bond was required in this particular case.

For the reasons I've just cited, I'm going to deny the motion for summary judgment, but without prejudice to the defense to raise it again. Now, I'm not inviting, in doing this, another voluminous round of material. I would like us to be focused on the issues I've raised.

And just as an aside for a second, I'll say this: I was reading an article the other day of how judges ought [36] to conduct themselves, and the author of this particular article was saying judges drive attorneys crazy by saying, "Motion denied. Motion granted," and not giving you any impressions. Of course, there's another school of thought that says every time you give your impressions, you get them force-fed back to you at a later time.

I'm going to give you some impressions I have right now to help guide you. My initial impressions are this: It's hard for me to see exactly what more Seabury & Smith could have been expected to do under these circumstances. And there has to be something more in my mind that these bonds run to the benefit of the investing public; and therefore, someone in the position of Seabury & Smith has to act like the FBI and go out and police these things. That's of great concern to me.

On the other hand, I also have some trouble with the idea that the responsibility lies totally with Kochcapital. That obviously is akin to asking the fox to police the hen house. So I have both those concerns, and you are now forewarned what is working on my mind at the moment.

I would like to set a time frame before which Seabury & Smith cannot bring the motion for summary judgment again to give all sides the opportunity to do [37] what discovery or what marshaling of assets they want to do in this case, and what do you folks think would be reasonable in that regard?

MR. ADAMS: Your Honor, before you address that issue, I apologize. I would like to put on the record

that National Union does also intend to bring a summary judgment.

THE COURT: Since a lot of the issues, I assume, will be similar, I would suggest that you be bound by the similar time lines, and I would just as soon hear from you also, Mr. Adams, as to what your thoughts are. What do you think would be fair?

MR. KEEFE: I don't intend to amend the Complaint anymore. This is the final. This is it. So – I've got three trials coming up in August, October, and December, and I'm a solo guy. It's hard for me to – so maybe September/October time frame. That's time to conduct some discovery.

MR. JOHNSON: Your Honor, my concern is: One, the questions that you've asked are not difficult questions and can be easily resolved and could probably be resolved based on affidavits or literature that already exists.

My second concern is the longer that we remain in this case the more expensive it is, and as you know from [38] our submissions, I don't think we belong here in the first place. We're running up a huge bill on what I firmly believe is a frivolous case, and I don't want to be in this until October.

I would like to have 60 days as the maximum amount of time. I would also ask that rather than deny the motion, you simply reserve it because that way the evidence – I don't have to resubmit the evidence to you. I mean, I would say we just hold the summary judgment motion; don't rule on it. We'll come back with answers to

these questions, and I would suggest that we limit rather than – perhaps we limit the pages that we devote to this to keep it to a manageable length.

THE COURT: I would agree wholeheartedly with that suggestion. I do prefer the idea of simply holding the motion in advance rather than forcing you to do submittals.

Were you going to say something, Mr. Keefe?

MR. KEEFE: Just briefly. It's very, very difficult for us to find an expert in these circumstances because the case is too complicated. It's not the expense that is the issue, but to find somebody with the NASD or with an insurance company that – well, experts say one thing, and they all – whatever. But my problem is not – my problem is being able to locate [39] somebody, because I guess this is what it's going to boil down to. You've got concerns between the relationships between the various entities, and so it's very difficult for us to operate on such a short time line because of these problems.

THE COURT: Mr. Adams, do you have any input on this?

MR. ADAMS: Shorter rather than later. I think 60 days would be adequate to get my materials submitted to the Court and noted for Your Honor.

THE COURT: Let me tell you one practical problem that may go to finding a middle ground for us. I'm scheduled to go out to our juvenile facility for a three-month period. When I go out there, I no longer handle our motion docket, and our "roving judge" would take that on, and I think it would be unfair to him to

saddle him with anything he hasn't heard concerning this.

I'm scheduled to be out there April, May, and June, so I would not be available until – excuse me – May, June, and July, so I wouldn't be available until August, and then I'm scheduled for vacation the first two weeks of August. So I would suggest the last week of August would be the earliest time that we could realistically

* * *

APPENDIX G

[1] IN THE SUPERIOR COURT OF THE STATE OF WASHINGTON

IN AND FOR THE COUNTY OF PIERCE

KOCHCAPITAL, INC., a stock brokerage firm; THOMAS CACCIOLA, et ux, et al.,	)	
Plaintiffs,	)	
vs	)	
SEABURY & SMITH, INC., a Delaware corporation; NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PA, a Pennsylvania corporation, et al.,	)	NO. 95-2-09591-2
Defendants.	)	

RULE 30(b)(6) DEPOSITION OF JAMES DAWSON

10:00 o'clock a.m.
October 22, 1997
999 Third Avenue, #1640
Seattle, Washington

SHERRI DEWITT, Court Reporter

[2] APPEARANCES

For Plaintiffs:	JOHN M. KEEFE Attorney at Law 10620 NE 26th Street Bellevue, Washington 98004
For Defendant Seabury & Smith:	PHILLIP H. GINSBERG CARL MARQUARDT Attorneys at Law 800 Fifth Ave., #4000 Seattle, Washington 98104
For Defendant National Union:	THOMAS D. ADAMS Attorney at Law 1601 Fifth Ave., #2400 Seattle, Washington 98101
For Deponent:	JOHN J. FLOOD Associate General Counsel NASD, Inc. 1735 K Street NW Washington, D.C. 20006

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[5] JAMES DAWSON, having been first duly sworn, testifies as follows:

DIRECT EXAMINATION

BY MR. KEEFE:

Q. Would you state your name and business address, please?

A. Yes. Jim Dawson. And I work at Two Union Square for the NASD, District No. 3 office.

Q. Would you describe your education, colleges attended and any advanced degrees obtained?

A. I have a Liberal Arts Degree from the University of Virginia.

Q. And the year obtained?

A. 1964.

Q. Could you describe your employment positions and responsibilities with each position you've held from college forward to the time you started with the NASD? And this can be brief, not detailed.

A. Right out of college, I was a management analyst for the U.S. Treasury Department from 1964 to 1968.

In 1968, I was a registered representative for the brokerage firm of Mason and Company. I was based in Washington, D.C. at that time. And I joined the NASD in November 1969.

Q. Could you describe the positions you've held with

* * *

[100] in that sentence and required net capital as it also appears there in that sentence?

A. Net capital is the amount of capital that the firm has when it computes its net capital as required under 15c3-1, which is quite different than what the required capital of the firm is pursuant to the rule.

Q. Okay. Why would Kochcapital be a firm with a required net capital of $25,000, if you understand the question?

A. I don't understand the question.

Q. All right. Let me try to rephrase it this way. Why would Kochcapital have a required net capital of $25,000?

A. Because they make markets.

Q. Okay.

A. And they introduce their transactions to the firm on a fully disclosed basis.

Q. Okay.

A. The firm's type of business, how it does its business, and the type of business determines what minimum net capital requirement they have to comply with under the rule.

Q. You are familiar with the company Seabury & Smith?

A. Not really, I'm not. No.

[101] Q. No? Okay. Then you are not familiar, are you, with the other providers of fidelity bonds to broker dealers in the securities industry that are out there in the market?

A. I'm not an expert as to the number of providers for fidelity bond companies.

Q. You wouldn't know there whether they require audited financial statements, companies out there providing fidelity bonds to broker dealers?

MR. FLOOD: As part of the application process; is that the question?

MR. KEEFE: Uh-huh.

A. Are you saying that they require an audited financial statement before they will bond a broker dealer?

Q. No. No, that's not my question. My question was then you wouldn't know whether other companies that provide fidelity bonds require audited financial statements as part of the application process?

A. Yeah, I really don't know that.

MR. KEEFE: If I could get this marked as Exhibit 20, and this is the NASD, Fidelity Bond Rule, Section 32, under the Rules of Fair Practice. And she didn't copy all the rule out there, so I'm going to pull this – okay.

* * *

[111] A. That it had the minimum coverage required under the fidelity bonding rule, yes, we would, that's our primary, our job when we do examinations when we get to the fidelity bonding rule.

Q. Okay. But you are not familiar with the procedures, are you, in which fidelity bonds are issued in terms of the amount of the bond, underwriting risks?

A. No, I'm not an expert in that area.

Q. Would it be fair to say that you wouldn't know how companies calculate, companies that issue fidelity bonds for broker dealers, that you wouldn't know how companies calculate what a member's fidelity bonding coverage should be?

MR. FLOOD: Objection for lack of foundation. There's been no testimony whatsoever that outside companies even calculate that amount. And Mr. Dawson has testified that he is familiar with the calculation of the required amount.

MR. ADAMS: I'll join, and add the objection that you are assuming such companies would have that obligation. I don't believe there's any facts and certainly no law to support that.

Q. All right. Well, let me ask this question. How do

[112] companies that issue fidelity bonds for broker dealers, how do they calculate what the amount of a fidelity bond should be?

A. I don't know.

Q. Well, I think we'll go to the Focus Reports now. The question hasn't been answered, but I'll wait on that.

MR. FLOOD: Off the record for a minute. (Off the record discussion.)

MR. KEEFE: And I just want to state on the record that I didn't bring the applications because that was the subject of some questions with Seabury & Smith.

MR. FLOOD: Okay.

MR. KEEFE: A little bit with National Union, and didn't seem pertinent to this deposition, but now it's got –

MR. FLOOD: We're grateful for your forbearance.

MR. KEEFE: Well, now it's becoming pertinent, but I didn't bring it. Maybe we can bring it out in the Focus Reports a little bit.

MR. FLOOD: I think it's Item 11.

(Pause in proceedings.)

Q. I've got a number of Focus Reports here, but I

[113] didn't want to go through all of them, just –

MR. FLOOD: Thank you.

MR. KEEFE: Okay.

MR. FLOOD: They make the net capital rule look interesting by comparison.

MR. KEEFE: I'm sorry?

MR. FLOOD: They make the net capital rule look interesting by comparison.

MR. KEEFE: Okay.

Q. The question I want to ask at this point, without marking any of these as exhibits, who is it that fills out these Focus Reports? Would that be somebody with the broker dealer?

A. Yes.

Q. Does the NASD audit these reports?

A. We verify the financial reports when we go in to do an examination and if it's part of our examination. We do lots of different examinations, but when we do what we call a cycle examination, generally we do verify the accuracy of the financial reports.

Q. In the 1990 time frame, how often, if you recall, did the NASD make these examinations of Kochcapital?

A. In 1990, I think we were concentrating on 15c2-6,

[114] that was the focus of our interest at Kochcapital in 1990.

Q. But in that time frame, Kochcapital was submitting its Focus Reports?

A. Yes, it is was.

Q. Do you recall if the NASD was conducting audits of any sort of its Focus Reports in that time frame?

A. No, I'm not aware that we were at all involved in verifying the accuracy of their financial reports. As I've testified, we were very interested in their compliance with 15c2-6.

Q. Okay. Would I be incorrect if I were to assume that I could put any figures on these Focus Reports that we're talking about here now and not worry about the NASD finding out unless there was an audit?

A. I think you'd be a damn fool if you just put any numbers you felt like putting down there. And in my experience in the NASD, I've never seen that happen.

Q. But, for example, a broker dealer that's in financial trouble and it didn't want the NASD to discover that, so the comptroller or the financial person changes the figures to fool the NASD so that they don't come in and shut them down or turn them

[115] over to SIPC –

A. That's been known to happen. Yes. Yes.

Q. Okay. If that were to happen, is it possible that the NASD might not discover that, for example, for a two- or three-month period of time?

A. Oh, absolutely, it's possible.

Q. Could it go undetected for a six-month period of time?

A. Yes, if a firm wants to dummy up its records and submit false financial reports, they could get away with it until we go in and try to authenticate their financial filings.

Q. In verifying the financials, what would the NASD do?

A. We'd go in and look at their trial balance and their net capital computation and their balance sheet. And we'd look at the general ledgers at the firm to see that the general ledgers accurately report all transactions taking place in the firm and all revenue and all expenses. And we make sure that the cash that they represent as being on deposit at the bank is actually on deposit. We look at their receivables. We look at their liabilities, and make sure that the firm's monthly requirement to compute net capital and do trial

[116] balances is accurate.

Q. If the NASD were to conduct an examination of this type, it would discover then falsified figures at that time?

A. It would depend.

Q. Through the examiner?

A. That's an impossible question to answer. It would depend on the circumstances.

Q. So then it could go undiscovered?

A. Anything is possible, yes.

Q. Even after an examination?

A. Yes. Yes. Yes.

(Off the record discussion.)

MR. KEEFE: We may be able to wrap this up in about 10 or 15 minutes.

(Off the record discussion.)

MR. KEEFE: Okay. I'd like to get these last three exhibits marked, and this one first. And I guess this would be 21?

THE REPORTER: Correct.

(Exhibit No. 21 was marked for identification.)

MR. ADAMS: What are those, John, Focus Reports?

MR. KEEFE: Yes.

• • •

[118] A. Yes, I am.

Q. Are you familiar with the requirements of any of these companies, the procedures, requirements of any of these companies as it relates to issuing fidelity bonds in the securities industry for broker dealers?

A. No, I'm not.

Q. If a broker dealer were to submit audited financials to a company that issues fidelity bonds, and we'll just state for now that Exhibit 21 is part of the information that would be submitted along with the fidelity bond application?

A. Is this an audited report? I don't think this is audited. I think this is a Focus Report done by somebody at Kochcapital.

Q. But let's just assume for purposes of this question that this is accurate.

If Kochcapital were to submit information as is contained in Exhibit 21 to a company that issues fidelity bonds for broker dealers, would I be accurate in saying that you wouldn't know how they would view the information here in Part A on net capital in terms of the requirements and procedures in issuing the bond and the amount of the bond?

MR. ADAMS: I'll object. Your question

[119] assumes they had an obligation to do anything with that information.

MR. KEEFE: Well, the question is hypothetical and the question asks if this information is submitted with a fidelity bond application, okay.

MR. ADAMS: I don't think there's any foundation at all for that question, legal or factual.

MR. KEEFE: Let me try to rephrase it.

MR. ADAMS: Okay.

MR. FLOOD: Are you looking to find out from the witness as to what the required bond amount would be?

MR. KEEFE: No.

MR. FLOOD: Because that he could tell you.

Q. A company that issues fidelity bonds to broker dealers, if it were in possession of this Focus Report, I would be accurate in saying that you wouldn't know how they would view this information here, Part A, Page 4?

A. That's true. That's true. I wouldn't know how they would view this.

Q. And in terms of setting the amount of the bond,

[120] your answer would also be the same since, based on your testimony, that you don't know how they would view this information?

MR. ADAMS: Objection, the companies don't set the amount of the bond. There's no factual or legal support for that question.

MR. KEEFE: You are testifying now, Tom.

MR. ADAMS: I'm stating an objection.

A. Repeat the question, please.

MR. FLOOD: Do you know how they would treat the information is the question.

MR. MARQUARDT: He's already said no.

MR. FLOOD: Isn't that where we are? Is there another question pending?

MR. KEEFE: Yeah, I'm trying to build on a previous question.

Q. In terms of setting the amount of a fidelity bond for a broker dealer, and we'll try to pinpoint this to the or confine it to the 1990 time frame, would it be fair to say that you wouldn't know how a company would view this information here in Part A, Page 4?

MR. ADAMS: Same objections.

Q. In terms of setting the amount of the bond?

MR. ADAMS: Same objections.

[121] Q. You can answer, if he knows.

MR. ADAMS: John, why don't you ask him if he knows how the amount of the bond gets set.

MR. KEEFE: That's not the question I want to ask, Tom.

MR. ADAMS: Okay. All right.

MR. MARQUARDT: We've already established that he didn't know that.

MR. ADAMS: All right.

MR. KEEFE: Well, –

MR. FLOOD: The question is do you know.

A. I do not know. I think I've testified to that. I don't know how an insurance company views the application process for a fidelity bond.

Q. Or in setting the amount of the bond?

A. Yes, I don't know how they – you know, I don't know if they do anything.

Q. Okay. Then your answer would be, "I don't know"?

A. Exactly.

MR. KEEFE: Okay. With that, I'm finished.

MR. FLOOD: Any other questions?

MR. ADAMS: Just one

REPORT OF THE FIDELITY BONDING COMMITTEE to the MEETING OF THE BOARD OF GOVERNORS of the NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

Irvington, Virginia

September 15 – 16, 1980

The Committee met in Washington D. C. on August 22, 1980. The primary purpose of the meeting was to evaluate the findings of the New York Stock Exchange fidelity bonding study which was conducted by Alexander and Alexander, Inc. (A&A) and financed by 97 members of the Exchange.

Present at the meeting were the two A&A staffers who were primarily responsible for the study. They reviewed the study and their conclusions (See Appendix "A").

They made the following recommendations to the NYSE:

1) An industry captive insurance company was feasible and should be formed.

2) Stringent loss control procedures should be established.

3) A centralized data collection system for insurance information about fidelity bonding premiums, coverages, losses and their causes should be established.

4) A group-buying program for small and medium-sized members and other similar securities firms should be established.

The Committee discussed each of these recommendations:

The Formulation of an Industry Captive

The Committee noted that the study indicated that a captive was a viable concept if it assumed all the fidelity risk of all NYSF members. If it assumed only a part of the risk it would not be profitable. A&A also recommended the establishment of a captive on a standby basis, because such a captive might have an influence on the level of fidelity bonding premiums even if it never became operational.

The NYSE Insurance Committee is lukewarm to the idea of a captive since its formation would require large expenditures of time and money and there was little possibility that it would be profitable.

The representatives of A&A reported that the formation of a captive was unlikely.

A captive would necessarily involve the largest firms. It was doubtful that a large well-run firm with no or few losses would be willing to contribute a large amount of capital to a captive which would be used primarily to pay the losses of less well-run firms of the same size who experienced multiple losses.

The Fidelity Bonding Committee does not believe that a captive will be organized since it would be impossible for such to accept all the fidelity risk and any lesser assumption of risk would mean that it would be unprofitable. The loss experience is also characterized by a small number of claims for high amounts and experience from year to year is extremely volatile. In this environment it is doubtful that a captive could be successfully capitalized to take care of all the losses and one very severe loss could still damage it irreparably (It was reported at the meeting that three $5 Million claims are pending currently).

Establishment of a Centralized Data Collection System and a Loss Control Program

While the Fidelity Bonding Committee felt that data collection would probably be helpful in providing facts on which to base future insurance programs, it had some reservations about the willingness of securities firms to report data that they would prefer to keep confidential. It appeared from the study that most losses occur in large firms and that multiple losses occur in those firms where

managerial attitudes condone less stringent procedures than in those firms that suffer no losses. The Committee felt that there could be more sharing of proven loss control methods and procedures amongst the large securities firms.

A Group-Buying Program

The Fidelity Bonding Committee felt that a group-buying program would have the most appeal to NASD members since such a program might reduce bonding costs and provide more ready access to bonding coverage. The major problems of NASD members in the bonding field seem to be availability and high price. If NASD members' loss experience parallels that of the smaller NYSE members – (few claims for relatively small amounts) – and the Committee feels that it does – a group program would make sense.

The view was also expressed that a group program might tend to equalize bonding costs for firms similarly situated (e.g. introducing firms or those marketing limited partnerships). Currently, there is little uniformity in premium rate levels amongst firms whose securities business and methods of operation are essentially the same.

However, some Committee members cautioned that if a group program was initiated with one carrier and the carrier later decided to withdraw because of reassurance problems, adverse experience or for other reasons, it might be difficult for members to secure coverage elsewhere, since the total market for bonds might well have shrunk considerably. The answer might be to use several carriers or design a group program that would be guaranteed for a number of years.

The Committee believes that a group program is worth exploring and, accordingly, makes the following recommendation to the Board of Governors:

RESOLVED:

That a preliminary investigation of the possibility of establishing a group-buying program be initiated and that contact be made with the other industry trade and regulatory organizations (NYSE, SEC, SIA, etc.), to determine their degree of interest in becoming involved in the project.

APPENDIX H

****
*** ACTIVITY REPORT ***
****

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To Andy Forstanzer	From Christie Pardle
Co. MMT	Co. Seabury + Smith
Dept.	Phone #
Fax # 212-345-5627	Fax #

Don't Use
- AGAIN -
212-770-7951
re: Kochcapital

IMPORTANT MESSAGE

FOR MM
DATE 3-4-94 TIME 345 A.M. P.M.
M Andy Forstanzer
OF Seabury Smith
PHONE 212 345-5629 (AREA CODE / NUMBER / EXTENSION)
☐ FAX
☐ MOBILE (AREA CODE / NUMBER / TIME TO CALL)

TELEPHONED	X	PLEASE CALL	X
CAME TO SEE YOU		WILL CALL AGAIN	
WANTS TO SEE YOU		RUSH	
RETURNED YOUR CALL		SPECIAL ATTENTION	

MESSAGE 3-4-94
wants copy of our contract w/ Alb and NASD - also any material sent to missed.

SIGNED

TOPS FORM 3002S LITHO IN U.S.A. 212-345-5627 -FAX

Koch Capital
212-345-5629
Andy Forstanzer

21038

BEST AVAILABLE COPY